Central R. R. Company v. *City of Bucyrus*.[21] Applying the rule of that decision to the instant case should we say that the corporation and the majority stockholders, having invoked the provisions of Ohio G.C. sec. 8623-65, will not be permitted to claim the unconstitutionality of any part of Ohio G.C. sec. 8623-72, because the latter section is made a part of the former one? The court answers this by saying that the one section is not made a part of the other, that they are separate and distinct and cover different subjects, Ohio G.C. sec. 8623-65 authorizing the corporation to sell its assets upon a favorable vote of the stockholders, and Ohio G.C. sec 8623-72 dealing with the rights of dissenting stockholders after the vote.

This view of the court seems to ignore the intent of the legislature as evidenced by the language of the statute, and the obvious purpose of protecting minority stockholders. The last paragraph of Ohio. G.C. sec. 8623-65 states, "Dissenting shareholders, whether or not entitled to vote, shall be entitled to relief in the manner and under the conditions hereinafter provided." A sale of substantially all of the assets of an Ohio corporation may be had only by compliance with this section, and when they authorized the sale the majority impliedly agreed to provide for dissenters. To what relief are the dissenters entitled? Why, to that "hereinafter provided," and the only relief hereinafter provided is that provided in Ohio G.C. sec. 8623-72, which is entitled, "Dissenting Shareholders." J.M.B.

Corporations — Vested Rights in Accrued Cumulative Dividends — Power of Cancellation Under New Amendment to Statutes

By the articles of incorporation of the defendant corporation, organized in 1923, certain shares of preferred stock were issued with 7% cumlative dividends. In 1935, the articles were amended to provide for an exchange of the first issue carrying 7%, for the new issue of 5%, with a 2½% dividend on the new stock payable immediately, and also for the issue of one share of new common, admittedly worth about $6.00, in cancellation of all accrued and unpaid dividends on the old preferred, which amounted to $24.50. The plaintiff, a holder of the original preferred, refused to exchange his old stock for the new issue and sued to enjoin the payment of dividends on the common stock until the unpaid cumulated but undeclared dividends, which had ac-

[21] 126 Ohio St. 558, 186 N.E. 450 (1933). In this case the court, having declared the statute involved to be unconstitutional, nevertheless declared that a party claiming constitutional invalidity while having received and still holding the fruits of an agreement made under the statute is estopped from questioning its unconstitutionality.

crued prior to the amendment to the articles, were paid. The court *held* that while the plaintiff must either exchange his old preferred for the new stock or take advantage of the appraisal statute, he could not be compelled to accept the common stock in extinguishment of his right to cumulated dividends accrued before the amendment became effective.[1]

Under similar statutes, it has several times been held that a corporation may amend its articles so as to call in outstanding stock to be exchanged for a new issue carrying a lower dividend rate.[2] The importance of the present decision lies in its effect upon amendments to articles for the purpose of wiping out accrued dividends. If, by amendment, a holder of preferred may be compelled to accept a six dollar share of stock for $24.50 of accrued dividends, it is a simple step further to say that those dividends may be destroyed entirely.

The Ohio Constitution has an usual provision reserving to the state the power to alter or repeal corporation charters.[3] Under this section it has been held that when a shareholder buys his stock, he does so with a full understanding that his rights may be altered by subsequent acts of the legislature.[4] At the time the principal case was decided the corporation statutes provided that charters might be amended so as to "change the express terms and provisions of any class or classes of shares; or of any series."[5] This was interpreted to mean that the provisions of any class or series could be changed as to *future* rights and privileges only. Since the statute said nothing about accrued undeclared and unpaid dividends, any amendment to diminish or to extinguish them was without statutory authorization. There is an implication in the opinion that if the statute had specifically mentioned wiping out accrued dividends, such action would have been legal, if the dividends had accrued after the effective date of the statute. Since the principal case was decided, the legislature has amended the corporation statute so that now, in unequivocal terms, a corporation may amend its articles so as not only to diminish, but to destroy all accrued unpaid dividends.[6]

[1] Harbine v. Dayton Malleable Iron Co., 61 Ohio App. 1, 22 N.E. (2d) 281, 14 Ohio Op. 276, 28 Ohio L. Abs. 625 (1939). For contemporary comment see (note) (1940) 25 CORN. L.Q. 431.

[2] Williams v. National Pump Corporation, 46 Ohio App. 427, 188 N.E. 756, 39 Ohio L. Rep. 469 (1933). Keith v. State *ex rel.* Mills, 113 Ohio St. 491. Morris v. American Public Utilities Co., 14 Del. Ch. 136, 122 Atl. 696. See generally 7 FLETCHER CYC. CORP. (PERM. ED.) sec. 3696.

[3] Art. XIII, Sec. 2.

[4] Williams v. National Pump Corp., *supra,* note 2. Cf. Geiger v. American Seeding Machine Co., 124 Ohio St. 222, 177 N.E. 594, 79 A.L.R. 614, 28 Ohio N.P.C.N.S.) 20.

[5] OHIO G.C. sec. 8623-14 (i). See note 6 for statute as changed.

[6] OHIO G.C. sec 8623-14 (i): "In particular, without prejudice to the generality of such power of amendment, a corporation may by amendment . . . change any or all of the express terms and provisions or designations of issued or unissued shares of any class or series; which change, if desired, may include the discharge, adjustment or elimination of rights to accrued undeclared cumulative dividends on any such issue. (Effective July 24, 1939).

A month prior to the decision in the *Harbine* case, the Eighth District Court of Appeals decided the case of *Vulcan Corporation* v. *Westheimer & Co.*[7] There, the plaintiff had amended its articles so as to compel the holders of 6% outstanding preferred with cumulative dividends to exchange one share of the original for one share of cumulative preferred bearing 4½% dividends, and one-half share of 3% convertible preferred, and one dollar in cash. The surrender of the old stock and the acceptance of the new constituted a waiver of all rights to accrued undeclared dividends amounting to $57 per share. The defendant, holding 44 shares of the original 6% cumulative preferred, upon being duly notified of the amendment, wrote in answer: "I hereby notify you that it is my desire to retain the old preferred stock." The plaintiff asked that the defendant be enjoined from asserting any claim or right in opposition to the plan of recapitalization. The court held that the defendant was concluded by the two-thirds vote of the shareholders from making any claim in opposition to the plan, and that since he had not asked for an appraisal he, along with the other shareholders, must accept the new stock, which acceptance constituted a waiver of accrued dividends.[8] In this case, as in the *Harbine* case, the court based its decision in large part on a dictum in *Johnson* v. *Lamprecht*[9] that the remedy offered in the appraisal statute was not exclusive "in instances where fraud and illegality are concerned." In the *Harbine* case, it was claimed that the proposal was illegal, it being without statutory authorization. In the *Vulcan* case, the court makes specific mention of the fact that "there is no claim of fraud or illegality concerning the plan of recapitalization nor is any claim made that the proposal was not for the best interests of the corporation."

Does a shareholder have a "vested right" in accrued undeclared and unpaid dividends of which he cannot be divested by charter amendment? The court in the *Vulcan* case does not meet this issue squarely because the defendant claimed he had a vested right in the stock itself as well as in the dividends which had accumulated, and he apparently was unwilling to accept the fair cash value of his stock. There is an intimation that he did have such a right of which he could not be divested if he had acted in compliance with the appraisal section when the court says, "The

[7] 14 Ohio Op. 274, 27 Ohio L. Abs. 694 (1938); appeal dismissed 135 Ohio St. 136 (1939): "for the reason on debatable constitutional question is involved in the cause." Note the appeal was dismissed after the decision in the *Harbine* case.

[8] The court emphasized the fact that the dividends had never been declared. In this it follows the reasoning of Judge Learned Hand dissenting in Harry v. Pioneer Mechanical Corp., 65 F. (2d) 332, 336 (1933) in interpreting the Delaware statute, which interpretation was not followed by the Delaware court.

See OHIO G.C. sec. 8623-72 for appraisal provisions. See comment, (1940) 6 O.S.L.J. 308, *supra*.

[9] 133 Ohio St. 567, 15 N.E. (2d) 127, 11 Ohio Op. 297 (1938).

fair market value of defendant's stock one day before the adoption of the plan of recapitalization necessarily included the value of the stock *with the accumulated dividends.*" (Italics supplied.) In the *Harbine* case, it is recognized that a shareholder has some right in accumulated dividends of which he may not be divested when, after calling attention to the rulings in Delaware and New Jersey that a stockholder has a "vested interest" in cumulated dividends, the court said: "We have difficulty in following the designation 'has a vested interest.' However, by whatever name known, it is an existing substantial right, and has a prospective value. Whether or not it will ever materialize, depends on whether or not the company makes profits in such an amount as to be available to pay the current and cumulative dividends."

The Delaware cases dealing with the cancellation of dividends are worthy of note. In *Keller* v. *Wilson & Co., Inc.*,[10] the corporation was organized in 1925 with a provision in its charter that it might "exercise all powers which might thereafter be conferred by the state by way of amendment of the act under which the corporation was created." In 1927, section 26 of the corporation statute was revised to read as follows: "Any corporation of this state . . . may . . . amend its certificate of incorporation . . . by changing the number, par value, designations, preferences, or relative, participating, optional, *or other special rights of the shares*, or the qualifications, limitations, or restrictions, of such rights." (Italics supplied.)[11] The corporation amended its charter destroying all accrued and unpaid dividends. While the lower court held it might accomplish this result,[12] on appeal the decision was reversed and it was held that the statute was not broad enough to permit of cancellation of dividends accrued before the amendment to the charter by the corporation.[23]

While the federal court, in construing the statute in an earlier case, found that it was broad enough to encompass such a change,[14] the Delaware court, when the problem was presented to it, refused to give it such a broad construction. In *Consolidated Film Industries, Inc.*, v. *Johnson*,[15] the corporation was organized *after* the amendment to section 26. But the court held that that fact was not sufficient to warrant the cancellation of accrued dividends. When its attention was specifically called to differences in the statutes under which the corporation in the *Keller* case was organized and that in force when the Consolidated Film Cor-

[10] 190 Atl. 115 (Del. Sup. Ct., 1936).
[11] Del. Revised Code 2058 sec. 26 (1935).
[13] *Supra*, note 10.
[14] Harr v. Mechanical Pioneer Corp., *supra*, note 8.
[15] 197 Atl. 489 (Del. Sup. Ct., 1937).

poration was organized, the court said: "It (the statute as amended) authorizes nothing more than it purports to authorize, the amendment of charters. The cancellation of dividends already accrued through passage of time is not an amendment of a charter. It is the destruction of a right in the nature of a debt. . . . The rights of cumulative preferred shareholders to the stipulated dividends accrued to them by virtue of the contract. The right exists and persists." This theory of vested rights in dividends had been articulated in an earlier case when the court said, "Considering the relations of the stockholders *inter sese* . . . there is every reason to hold that as soon as the agreed dividend which the preferred stockholder is to receive is matured by time, a right to its ultimate payment as against those who have agreed to its payment becomes a vested right. It is a present property interest."[16]

Ohio has never adopted this theory of vested rights in accrued cumulative dividends *in toto*. In *Johnson* v. *Lamprecht*, the court had only to decide whether a prior preferred stock could be issued on which dividends were legally payable before dividends cumulated prior to this issue were paid to the original preferred. While deciding this under a strict interpretation of the agreement as set forth in the stock certificate, the court discussed at some length the theory of vested rights. Said the court, speaking through Judge Gorman, "It is claimed that the cancellation of an accumulated and unpaid dividend of a preferred holder impairs a vested right. If there is a surplus, the action is usually enjoined. If on the other hand, there is a need for additional capital, the corporate necessity for continued existence overshadows the claims of the minority holders to dividends. In determining the question, courts have considered both the equities and the business situation, attempted to weigh and balance them, and then decided the controversy." In that case, the matter of vested rights was not primarily important since the exchange of the old preferred for the new (less accumulated dividends) was purely optional. Vested rights problems arise where the exchange with the accompanying cancellation of accrued dividends is compulsory. Although the entire discussion is *obiter*, the court seems to be saying that where there is a sufficient surplus to pay dividends and compulsion is used to cancel those already accrued, the court will apply the vested rights theory to protect the shareholder, and that the dividends may be destroyed where there is not a sufficient surplus.

Up to this point, the matter of vested rights has been decided on the basis of statutes which were held to be prospective in effect only, and not retrospective.[17] Both the Delaware and the Ohio statutes authorize

[16] Morris v. American Public Utilities Co., 14 Del. Ch. 136, 149 (1923).

[17] See principally in this connection Consolidated Film Industries Inc. v. Johnson, *supra*, note 16. Contrast with this the much more liberal attitude shown by the court

corporations to make amendments to their charters in regard to certain preferences. In the absence of unambiguous statements to that effect, the courts have refused to give the statutes such broad interpretations as to allow, without more, a cancellation of dividends which had accrued.[18] All attempts in Ohio to date have been denied on the ground of *illegality* because there was no statutory authorization for the cancellation of dividends accrued through passage of time.[19] The new provision specifically reserves in the corporation the power to cancel accrued dividends.[20]

The question may arise as to whether a corporation must have been organized subsequent to the passage of the statute permitting amendment of the charter to cancel accrued dividends in order to benefit by it, or whether it is necessary that the stock be issued after its effective date. Inasmuch as amendments to general corporation statutes become part of the charter of a corporation as of the day of promulgation, it would seem to be unnecessary that a corporation be organized after the passage of the statute. While the statute would have no retrospective effect as to dividends which had accrued before its effective date, it would apply to all dividends accrued in the future. The time of issuing the certificates of stock would not seem to be controlling. "Purchasers of stock are chargeable with notice that the legislature may make provision for amendments and alterations and when made all certificates of stock, whether issued before or after, are brought within its provisions."[21] It would seem from the decisions reviewed that the new amendment will not be effective to cancel dividends accrued prior to its enactment, but that all dividends which accrued subsequent to its passage may be cancelled by proper amendment to the charter of the corporation, and this without regard to when the corporation was organized, or when the stock was first issued or acquired by the holder.

D. R. T.

---

in regard to cancellation of dividends in connection with merger. It will be noted here that the court interpreted the statute dealing with merger and consolidation as having retrospective effect. Federal United Corporation v. Havender *et al.*, 11 A. (2d) 331 (Del. Sup. Ct., 1940) *Cf.* Goodison v. North American Securities Co., 40 Ohio App. 85, 178 N.E. 29; Windhurst v. Central Leather Co., 107 N.J. Eq. 528, 153 Atl. 402 (1930).

[18] See generally 7 FLETCHER, CYC. CORP. (PERM. ED.) sec. 3688, 9696 and cases cited *supra*, notes 3, 5, 12 and 14.

[19] Williams case; Harbine case, *supra*, notes 2 and 3.

[20] *Supra*, note 6.

[21] Harbine v. Dayton Malleable Iron Co., *supra*, note 2. "A purchaser of corporate stock takes it with full knowledge that provisions contained in the certificate may be altered or amended."