THE RIGHTS OF MINORITY STOCKHOLDERS

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INTRODUCTION[1]

The modern business corporation is composed of highly diversified interests. The owners, i. e., the stockholders, seldom come into contact with each other, and even at the annual meetings the stockholders of large corporations are usually represented by proxy. There will be one faction which dominates the organization, which element is known as the majority, and another faction known as the minority. The term "majority" when so used does not mean the holder or holders of a majority of the stock, but the term refers to the person or combination of persons that has sufficient number of votes to control the organization and actually uses its power to dominate the company.

It is frequently stated that the holders of a majority of the stock are trustees for the minority, but this is inaccurate. For instance, fifty-one per cent. of the stock of a corporation may be held by an indifferent individual who does nothing but cash his dividend checks, and a combination of thirty-five per cent. of the stockholders may control the corporation completely. This combination constitutes the majority. If the indifferent stockholder above referred to should awaken some day to the fact that the majority were mulcting the corporation, and should desire to obtain legal redress at once, he would have to come into a court of equity as a minority stockholder.

The majority have been termed "trustees" for the minority. There is no technical trust, but it is true that the majority bear a fiduciary

1 See Gleick, H. S., M. A. L.

relationship to the rest of the stockholders which approximates the status of a trusteeship.

This relationship is one imposed by law because the fact that in its absence the majority could oppress and defraud the minority.

This division into factions results from the business interests of the stockholders. Domination of the corporation is not desired for its own sake--for the mere pleasure of running the organization--but because the control in one way or another redounds to the personal advantage of those in control. This being the case, it may be that when one faction gains control and thus becomes the majority, this faction in exercising control will use its power to advance its own ends. To a certain extent the law will permit this, but there is a point where the law will step in and protect the minority. The minority stockholders have certain rights which the majority must respect, and it is with these rights that this report is concerned.

There are two main classes of rights to which a minority stockholder is entitled; first, those rights which he has by reason of being a stockholder, and secondly, those rights he can enforce because of his status as a minority stockholder.

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Every stockholder is entitled to a certificate of his shares.[1] This share of stock is the right to participate in stockholder's meetings.[2] Regular stockholders' meetings are provided for in the charter or by-laws of corporations, as required by the general corporation laws. Regular meetings are generally held once a year on a regular date prescribed by the by-laws. A notice is always required in calling special meetings. The directors are elected, and reports heard, at the regular annual meeting. The officers who wrongfully refuse to call a meeting as they ought to do by law may be compelled to do their duty by the courts in a proceeding called a mandamus; in other words, the courts can compel the officers to call a meeting in obedience to the wishes and request of the stockholders. "What shall constitute due notice, however, is a serious question. The trend of development of this right has been to insist that notice shall be given at a certain time in advance of the meeting, and that it shall contain a statement of the subjects to be taken up."[3]

As a general rule, the acts of stockholders to be valid can be done in only one way, namely, at a corporate meeting which has been duly convened and conducted according to certain prescribed formalities. If there is the slightest possibility of any contemplated action of the stockholders being disputed either by the minority stockholders or by third parties, care should be taken that all the necessary formalities are observed. It is only by doing so that the majority stockholders can bind the corporation.

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1 105 U. S. 217

2 2 Woods 331

3 Haney, L. H., "Business Organization and Combination." The MacMillan Co., N. Y., 1925, page 265.

Under the law of nearly every state, three things are essential to the validity of action by stockholders. (1) The meeting at which the action is taken must be properly convened; (2) a quorum must be present; and (3) a certain specified number of stockholders must vote in favor of the measure.

It is generally provided that the meeting shall be called by a certain person or persons, in order to avoid confusion and dispute. If the person who is authorized to call meetings refuses to do so when he should, a stockholder may bring suit to compel him to perform his duty.

It is necessary that all the stockholders be given notice of the time and place of the meeting and of the business to be transacted, to properly convene a special meeting. Such a notice is required so that the stockholders may have an opportunity to vote upon any action which calls for the stockholders' approval. And even where no notice of a regular stockholders' meeting need legally be given, courtesy and good business practice cause most companies to give it the same as if it were required by law.

"The American Gold Mines Company entered into negotiations with the Consolidated Copper Mines Company with a view to merging. In order to effect this end, the American Company's officers called a meeting of its stockholders, the notices reading that the meeting was to be held 'for the purpose of considering a plan of amalgamating the interests and properties of this company with that of the Consolidated Copper Mines Company, and for such business in relation thereto, as well as the general business of the company, as may be presented to the meeting.' At the meeting, Smith, who had sufficient proxies to give him a controlling interest in both companies, put through a resolution for the issuance to him of certain stock in consideration of his services. The validity of this resolution was afterwards attacked on the ground, among others, that no notice of such a measure had been given to the stockholders. Held, the notice was insufficient to give the stockholders any intimation that such a measure would be presented at the meeting, and the resolution was therefore void. Smith, being in a position of control, was bound to be very frank with the minority stockholders, and could not properly cover his intentions to bring up his own claim at the special meeting by a vague notice that various matters in relation to 'the general business of the company' might be presented to the meeting."[1]

The second essential to the validity of any stockholders' action is that a quorum be present at the meeting where such action is taken. It is generally in a company's by-laws how many stockholders are required to constitute a quorum.

The third essential to the validity of stockholder's action is that it must be supported by the necessary number of affirmative votes. In the absence of express provisions requiring a certain vote, it has been held that a majority of the votes actually cast at a meeting is sufficient to validate a measure proposed and voted upon, provided a quorum is present. This does not mean that a majority of votes actually present is required, but merely a majority of the votes cast.

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[1] United Gold, etc., Co. v. Smith, 90 N. Y. Supp. 199 (1904).

THE RIGHT TO VOTE

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The right to vote belongs only to the stockholders. The right of a stockholder to have a voice in the management of his corporation is exercised through his voting power. This right may be, but seldom is, denied by statute.

The stockholder's right to vote is fundamentally important because through it he exercises his influence in the election of directors and sometimes its officers, and in passing upon all unusual corporate transactions such as an increase or decrease in capital stock, changing the par value of its shares or its corporate name, creating preferred stock, consolidating or merging with another corporation, or effecting a dissolution. This is the most important power which the stockholder has since as long as the management is honest and within the corporate powers, the stockholders cannot interfere, even though the administration is weak and unsatisfactory. They must correct such an evil through their power to elect other directors. A case from New York is the basis for this statement:

"The right to vote for directors, therefore, is the right to protect (the corporate) property from loss and make it effective in earning dividends. In other words, it is the right which gives the property value and is part of the property itself, for it cannot be separated therefrom. Unless the stockholder can protect his investment in this way he cannot protest it at all, and his property might be wasted by feeble administration and he could not prevent it. He might see the value of all he possessed fading away, yet he would have no power, direct or indirect, to save himself or the company from financial downfall. With the right to vote, as we may assume, his property is safe and valuable. Without that right, as we may further assume, his property is not safe and may become of no value. To absolutely deprive him of the right to vote, therefore, is to deprive him of an essential attribute of his property."[1]

"Stockholders are not disqualified to vote upon a matter coming before a stockholders' meeting because they have a personal interest in the matter to be voted upon."[2] That is, stockholders can vote upon a proposition to ratify a purchase of property from themselves, which they, as directors, had assumed to make on behalf of the corporation.

At common law each stockholder had but one vote. Now almost everywhere a stockholder has a vote for each share of stock which he owns. For example, if you own one hundred and fifty shares of stock in a corporation, you have to-day one hundred and fifty votes; whereas at common law you would have but one vote. The corporation statutes generally make the books of the corporation conclusive evidence of the ownership of stock and of the right to vote in virtue of such ownership.

Executors and administrators may vote the stock belonging to the estate which they represent before distribution. It is held that a corporation cannot vote its own shares itself. It may, however, vote shares of stock in another corporation which it has purchased.

Voting by Proxy

At common law, if a stockholder desired to exercise his right to vote he had to do so personally. The reason for this was that each stock-

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1 Lord v. Equitable Life Assur. Soc., 194 N. Y. 212, 228, 87 N. E. 443, 448.

2 Bjorngaard v. Goodhue Co. Bk., 49 Minn. 483, 52 N. W. 48.

holder was expected to exercise his individual judgment upon all measures. This was a great inconvenience since a great number could not attend the corporate meeting, because of sickness or distance from the place of meeting. The result was that he lost his vote. In order to remedy this situation, stockholders of business corporations are given the right to vote by proxy. Voting by proxy means that a stockholder has executed a power of attorney to another, who votes for him. This written authorization to some other person to represent and vote for him must be expressly conferred by the company's charter or by-laws. It has been held in a few states that authority to vote by proxy must be derived from statutory or charter provision; but the majority opinion is that such authority may be conferred by by-law. The length of life of a proxy is sometimes wisely limited by law. In New York, a proxy which does not specify the period for which it is to be valid, becomes invalid eleven months after the date of its execution.

The proxy right has been much abused, being used to secure a majority by getting the proxies of scattered small holders, and so to run corporations in an undemocratic way. It seems essential, however, that the distant holders of small amounts of stock should have the power to send their representatives.

Voting Trusts

The voting trust has become very common in recent years. It is an agreement between certain shareholders in a corporation to vote the shares of stock which they own in such manner as the majority of the shareholders who are parties to the voting trust agreement shall direct, or in the way some designated trustee of the stock or third party shall direct. Voting trust agreements are regarded as illegal and void in some jurisdictions. In a North Carolina case it was said: "In short, all agreements and devices by which stockholders surrender their voting powers are invalid. The power to vote is inherently annexed to and inseparable from the real ownership of each share, and can only be delegated by proxy with power of revocation."[1] The law of Connecticut was similarly enunciated in the Shepaug Voting Trust Cases.[2] Still, in California, Illinois, Massachusetts, New Jersey and New York, the voting trust is sanctioned provided that its purposes and object are proper and reasonable.[3]

The legality of these agreements depends almost entirely upon the motives and objects with which they are made. If the attempt is to obtain monopoly or to restrain trade then it is void as against public policy. The right to vote by proxy implies that the voting power may be separated from the ownership of stock. Where stockholders vest the voting right of stock in trustees, the legal title to the stock, with the voting rights, is in the trustees. All the other rights of stock ownership remain in the shareholders. For example, they still receive the dividends.

Cumulative Voting

Cumulative voting is unknown to the common law. Statutes in many states authorize cumulative voting in order to give the minority stockholders a chance to elect a representative to the board of directors.

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1. Harvey v. Linville Imp. Co., 118 N. Car. 693, 24 S. E. 489.

2 60 Conn. 553.

3 Smith v. San Francisco, etc., R. Co., 115 Cal. 584, 47 Pac. 582; Brightman v. Bates, 175 Mass. 105, 55 N. E. 809.

The stock corporation law of New York has a typical provision: "The certificate of incorporation . . . may provide that at all elections of directors . . . each stockholder shall be entitled to as many votes as shall equal the number of his shares of stock multiplied by the number of directors to be elected, and that he may cast all of such votes for a single director or may distribute them among the number to be voted for, or any two or more of them, as he may see fit."[1] In Illinois, Pennsylvania, and few other states it is expressly provided for by statute, while in Delaware, New Jersey, New York, and several other states it is authorized, if expressly provided for in a company's articles of association or by-laws. In Ohio, a constitutional provision secures and insures this right.

It may be illustrated thus: If you own ten shares of stock in a corporation having five directors, and would ordinarily only have the right to vote your ten shares for each of the five directors,or fifty for all of them; the cumulative vote permits you to vote your fifty votes for one director, instead of ten for each of the five directors as you are ordinarily compelled to do; or you may cast twenty-five votes for each of two candidates, and none for the others, or make such cumulation or separation of your votes as, in your judgment, will best serve your interests in getting representation in the directorate.

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1 Greeley, Harold Dudley, "Law for Laymen", American Institute Publishing Co. Inc. N. Y. 1932. p. 5, para. 1014.

RIGHT TO MAKE BY-LAWS

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A by-law is a rule adopted for the permanent government of the internal management of the corporation and its officers. Stockholders, except in a very few states, have the exclusive right to enact by-laws to govern the general conduct of corporate business. It is not unusual though for stockholders in those by-laws to delegate the power to alter or amend them to the board of directors. In some states, Illinois for example, the power to adopt by-laws is vested by statute in the board of directors. If the power to make the by-laws be not vested by law or by charter in any particular body, the directors for example, it resides in the members of the corporation at large and in them only.

What by-laws a company may make must depend on the charter and general statutes, as well as public policy. Not every by-law made by a corporation is valid, only those that are reasonable and needful to carry into effect the objects of the corporation. Justice Folger said: "All by-laws must be reasonable and consistent with the general principles of the law of the land by which they are to be determined by the courts when a case is properly before them. A by-law may regulate or modify the constitution of a corporation, but cannot alter it. The alteration of a by-law is but the making of another upon the same matter . . . But a by-law that will disturb a vested right is not such."[1]

Every member is bound by the by-laws adopted by the majority, but a non-member is not bound nor can he claim any right by force of a by-law.

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1 Kent v. Quicksilver Mining Co., 78 N. Y., 182.

The Supreme Court of Massachusetts has declared: "Strangers to the corporation cannot be bound by the by-laws adopted for the internal government of the company. The by-laws of a private corporation bind the members thereof only by virtue of their consent. They do not affect the outside parties. This seems reasonable when it is recalled that the office of a by-law is to regulate the conduct and define the duties of the members towards the corporation and between themselves."[1] The provisions are in the nature of a contract and the right of a third party, a stranger to the association, to establish a legal claim through such a by-law must depend on the general principles applicable to express contracts.

The following matters are ordinarily governed by provisions in the by-laws: The manner of calling and conducting meetings; quorums; the number of votes to be given by the stockholders; the powers and tenure of office of the corporate officers; the manner of voting by proxy, and the like.

The majority cannot restrict the free transfer of corporate stock, under the form of a by-law. Also, a corporation cannot create or declare a lien upon its stock by by-law. The Michigan court, and a few others, held otherwise and declared that a by-law creating a lien on the shares of a member for debts due by him to the corporation is valid and binding, though not as against innocent purchasers for value. "The National Banking Act forbids a national bank to provide for such a lien either in its articles of association or its by-laws."[2]

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1 Flint v. Pierce, 99 Mass. 68.

2 Third Nat. Bk. v. Buffalo German Ins. Co., 193 U. S. 581, 48 L. Ed. 801; Bridges v. Nat. Bk., 185 N. Y. 146, 77 N. E. 1005.

RIGHT TO DIVIDENDS

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The main thing that a stockholder looks to is the right which he enjoys as one of the owners of the concern, a share in its earnings. This usually comes to him in the form of dividends.[1]

"Dividends have been defined as that part of a company's profits which are appropriated by resolution of its board of directors for division, on demand, or at a fixed time among the stockholders according to their respective interests."[2]

We always understand a dividend to be a fund which the corporation sets aside from its profits, to be divided among its members. They can only be declared and paid out of net profits. The right of the corporation to declare dividends depends upon the state of the finances of the corporation when the dividend is declared. "The question usually is, whether or not there would remain a net increase upon the original investment, after deducting from the assets of the company all present debts and making provision for future or contingent claims."[3]

The power to declare dividends is given to the directors. They fix the amount the amount and the time and manner of payment. The stockholders have no fixed and certain rights without the declaration of a dividend. They have only a potential right to participate in the profits of the enterprise according to their respective interests.

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1 75 N. Y. 211; 92 N. Y. 592; 3 Wall 585; 2 Woods 331.

2 Sullivan, John J., "American Corporations," D. Appleton and Co., N. Y. 1910. para. 278.

3 Crawford v. Roney, 130 Ga. 515, 61 S. E. 117.

When the corporation declares a dividend it means that it is in a condition to make a division of profit and is prosperous. If a dividend is declared and the capital must be used for this purpose, it is looked upon as highly discreditable, if not absolutely dishonest and fraudulent. The legislature of most states has provided for penalties where dividends are declared out of anything except surplus profits, or where the corporate capital stock is divided or withdrawn. When a dividend has been declared it becomes a debt, due to the stockholder from the corporation.[1] If the corporation refuses to pay the dividend when thus due, a stockholder may maintain an action for the amount of his dividend.[2]

The dividends must be general on all the stock so that each stockholder will receive his proportionate share. The directors have no right to declare a dividend on any other principle. They cannot exclude any portion of the stockholders from an equal participation in the profits of the company."[3]

A person who becomes a stockholder immediately before declaring a dividend is entitled to his proportion, nor can the directors exclude him.

In the absence of fraud or bad faith, no stockholder can compel the board to declare a dividend, even if profits are available. A leading New York decision states the prevailing rule in this way: "When a corporation has a surplus, whether a dividend shall be made, and if made, how much it shall be, and when and where it shall be payable, rest in the fair and honest discretion of the directors uncontrollable by the courts."[4]

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1 King v. Paterson & Hudson River Co., 29 N. J. Law 504; Lockhart v. VanAlstyne, 30 Mich. 76.

2 57 N. Y. 196; 49 Pa. 270; Chase, Dec. 167.

3 Snyder v. Alton & Sangamon R., 13 Ill., 516.

4 Williams v. Western Union Tel. Co., 93 N. Y. 162, 192.

The directors cannot rescind their declaration of a dividend unless the company's financial condition would render the payment thereof illegal. If the declaration of a dividend by the directors creates a relationship of debtor and creditor between the corporation and a stockholder, it should follow that a board of directors may not lawfully rescind a dividend; but a Massachusetts case held otherwise, where the fact that a dividend had been declared was not made public or in any manner communicated to the stockholders.[1] This decision was recently bitterly criticized by the Appellate Court of Missouri, and was said to stand out "boldly, single and alone in this country against an unbroken line of cases."[2]

Stock Dividends

"A stock dividend is lawful when an amount of money or property equivalent in value to the full par value of the stock distributed as a dividend has been accumulated and is permanently added to the capital stock of the corporation."[3]

In a Leading New York Case, Judge Earl said: "Stock dividends never diminish or interfere with the property of a corporation, and hence are not within the purview of that section (a statute forbidding the distribution of corporate capital in the shape of dividends). After a stock dividend a corporation has just as much property as it had before. It is just as solvent and just as capable of meeting all demands upon it. After

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1 Ford v. East Hampton Rubber Thread Co., 158 Mass. 84, N. E. 1036.

2 McLaran v. Crescent Planing Mill Co., 117 Mo. App. 40, 93 S. W. 819.

3 DeKoven v. Alsop, 205 Ill. 309, 68 N. E. 930.

such a dividend the aggregate of the stockholders own no more interest in the corporation than before. The whole number of shares before the stock dividend represented the whole property of the corporation, and after the dividend they represent that and no more. A stock dividend does not distribute property, but simply dilutes the shares as they existed before; and hence that section in no way prevented or related to a stock dividend. Such a dividend could be declared by a corporation without violating its letter, its spirit or its purpose."[1]

When Equity Will Decree Declaration

As previously stated, when a corporation has a surplus, whether a dividend shall be made, and if made, how much it shall be, and when and where it shall be payable, rest in the fair and honest discretion of the directors. This discretion is uncontrollable by the courts and will not be interfered with ordinarily. But courts will interfere upon suit by a stockholder and compel the declaration of a dividend if the directors have not exercised their discretion in a fair and honest manner. For example, a declaration was compelled upon proof that the directors in order to destroy the value of minority stock had refused to distribute profits, and in another case where the directors had used profits for the distribution of large allowances and commissions among themselves individually.

A large amount of surplus on hand is not sufficient to warrant court action. A well-known New York case makes the good faith of the directors the ultimate test.[2]

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1 Williams v. Western Union Tel. Co., 93 N. Y. 162.

2 McNab v. McNab & Harlin Mfg. Co., 62 Hun 18 (N.Y.). Affirmed 133 N. Y. 687, 31 N. E. 627.

In Louisiana, a court of equity ordered the declaration of a dividend of $50,000 where a very large surplus existed. "Directors must not accumulate too large a surplus and roll their profits year after year until the great snowball has been magnified twenty diameters. This results in the practical starvation of the stockholders, especially where the corporation is a private or close one, and there is no ready market for its stock. The only sure benefit to the stockholders to be derived from the successful prosecution of the corporate business must come from the distribution of dividends."[1]

Two cases to illustrate this section follows: "Beers, the owner of stock in the Bridgeport Spring Company, filed a bill in equity to compel the corporation to pay him certain dividends which had been declared by the board of directors. Held, when the directors declared the dividends in question, the portion thereof accuring to each stockholder was thereby severed from the common funds of the corporation and became his individual property. Thenceforth the company owed him a debt, payment of which he might demand, and upon refusal, enforce. No time having been specified for the payment of the dividends, the presumption of law is that they were to be paid within a reasonable time."[2]

"Fongeray, a director and a stockholder in the Laurel Springs Land Company, filed a bill in equity to compel a declaration of dividends. He proved that the company had surplus profits of more than twenty times the original capital and that those who constituted a working majority of the

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1 Raynolds v. Diamond Mills Paper Co., 69 N. J. Eq. 299, 60 Atl. 941.

2 Beers v. Bridgeport Spring Co., 42 Conn. 17.

board of directors had no honest purpose to enlarge the company's business, but under this pretext had refused to declare any dividends, while awaiting an opportunity to absorb the profits by fraudulent devices. Held, a dividend of all the net earnings not needed for the company's legitimate business must be declared. Furthermore, the directors must thereafter declare such reasonable dividends from time to time as the financial status of the business might warrant."[1]

Who is Entitled

"The law is well settled that whoever owns the stock in a corporation at the time a dividend is declared owns the dividend also. A transfer of the stock afterwards will not carry the dividend with it, though it may not be paid or payable, until after the transfer."[2]

Two illustrations follow:

Suppose A, the owner of fifty shares of stock in a corporation, executed his will on Aug. 1, 1935, in which he bequeathed the stock to B. On September 1, 1935, dividends of 4 per cent were declared payable in thirty days. A died on September 20, 1935. Who is entitled to the dividends? They go to the personal estate of A, and not to B. The reason is because A was the owner of the shares at the time the dividends were declared, and it makes no difference when the dividends were to be paid.

If X is the owner of shares when a dividend is declared, it belongs to him, though it does not become due and payable until after X has

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1 Laurel Springs Land Co. v. Fongeray, 50 N. J. Eq. 756.

2 Hopper v. Sage, 112 N. Y. 530, 20 N. E. 350; Bright v. Lord, 51 Ind. 272.

transferred his shares to Y. If X sells to Y before a dividend is declared, it belongs to Y, though it is declared before the transfer on the corporate books is made to Y. The corporation, however, will be justified in paying to X if it has no knowledge of Y's claim. If the corporation has notice, it is bound to pay the true owner.

Setting Apart of Specific Fund

When the stockholders are notified that a dividend has been declared, a specific fund is set aside and in the eye of the law is held by the company in trust for its stockholders. If the corporation goes into bankruptcy, the stockholders do not have to share equally with general creditors for such unpaid dividends. They may recover the whole of their share of the dividend. "The setting apart of a fund to pay a dividend gives a lien upon this fund to the stockholders, which they can enforce to the exclusion of the general creditors of the corporation."[1]

"Where no specific fund is set aside out of which the payment of the dividend is to be made, the shareholder is a mere creditor as to the amount of his dividend, and must share with the other creditors in case insolvency subsequently occurs before payment."[2]

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1 In re Le Blanc, 14 Hun 8 (N.Y.).

2 Hunt v. O'Shea, 69 N. H. 600, 45 Atl. 480.)

THE RIGHT TO SUBSCRIBE TO NEW ISSUE OF STOCK

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Another important right held by a stockholder is that of subscribing to new capital stock when the amount of the corporation's authorized capital stock has been increased. The stockholder is usually given the privilege of subscribing for more stock of the class, at a price below the market, or on such favorable terms as to make the privilege valuable. The courts have upheld this privilege on the ground that the new issue affects the value of the existing stockholder's equity and dilutes his voting power. The stockholder may demand such a proportion of the new stock as the number of shares already owned by him bears to the whole number of shares in existence before the increase. If he is not allowed this right his fractional interest will be reduced if the total number of shares issued is increased with no increase in his holdings. For example, if he holds 40 out of 100 shares, he has a 40% interest. If the number of shares is doubled, his 40 shares give him only a 20% interest. Thus every stockholder must be given the right to subscribe to new shares in proportion to his present holdings.

This right was denied to a stockholder in a recent decision of the New York Court of Appeals. Judge Vann said: "It (the right) is inviolable and can neither be taken away or lessened without consent, or a waiver implying consent. The plaintiff had power, before the increase in stock, to vote on 221 shares of stock, out of a total of 5,000, at any meeting held by the stockholders for any purpose. By the action of the majority, taken against his will and protest, he now has only one-half the voting power that he had before, because the number of shares has been doubled while he still owns but 221. This touches him as a stockholder in such a way as to deprive him of a right of property."[1] This right to new stock is his property, and cannot be disposed of without his consent, but can be transferred if he does not care to exercise it. "Unless he waives this right, he may maintain an action against the company, should it deprive him of them, for the loss he has sustained. The measure of damages is an excess of the current value of stock above the par value at the time of payment of the last installment with interest on the excess."[2]

If the new stock is issued in payment for property and not for cash, the stockholder does not possess this pre-emptive right to subscribe.

In an early Massachusetts case it was held that "when a banking corporation has been organized with a capital not less than one sum and not greater than another, and had commenced with the smaller capital, and afterwards voted to increase to the larger, those who held stock in the original capital possessed a prior right to subscribe to the new stock."[3]

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1 Stokes v. Continental Trust Co., 186 N. Y. 285, 78 N. E. 1090.

2 Boles, Albert S., "Business Man's Commercial Law Library," Doubleday, Page & Co., N. Y. 1919. Vol. 4, page 821, sec. 14. b.

3 Gray v. Portland Bank, 3 Mass. 364.

THE RIGHT TO INSPECT CORPORATE BOOKS AND RECORDS

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The books of a corporation are said to be the common property of all the stockholders[1] and are subject to their inspection for proper purposes and at proper times.[2] As a general rule, the stockholders have the right to inspect the books of the company if they do it at the proper time and for the proper purpose. It is necessary at times for stockholders to examine the records in order to find out whether or not the directors and officers are conducting the business properly. In nearly all the cases the records are the only place from which this information can be obtained.

"The stockholders of a corporation are the equitable owners of its assets, and the officers act in a fiduciary relation as agents of the corporation and of the stockholders. They should be ready to account to the stockholders for their doings at all reasonable times, and the stockholders have a right to inspect their records and accounts, and to ascertain whether they are faithful, honest, and intelligent in the performance of their duties. There is no good reason why the stockholders, acting in good faith for the purpose of advancing the interest of the corporation and protecting their rights as owners, should not be permitted to examine the corporate property, including the books and accounts."[3]

The right of inspection includes the right to have the assistance of an expert accountant and an attorney, and it also includes the privilege of making transcripts from the books and records for subsequent use.

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1 105 Pa. 111

2 51 Fed. Rep. 61; 40 N. J. Eq. 392.

3 Varney v. Baker, 194 Mass. 239, 80 N. E. 524.

This right of inspection, as it exists at common law, is not an absolute right. The inspection must be made for a specified and proper purpose, and application must be made to the proper custodian of the books during business hours. "A stockholder has no right to inspect his company's books and papers for purposes of speculation or merely to gratify his curiosity. If the stockholders were given an unlimited right of inspection, the business of the corporation would be subject to continual interruption."[1] It interferes with the affairs of the company to have a stockholder examine the records because he may be on bad terms with an officer of the company.

"George H. Sellers was a stockholder in the Phoenix Iron Company. He alleged that for many years the company had been prospering, although no dividend had been declared; also that the business was being fraudulently managed by the directors and that they were misapplying the company's funds and property. Sellers requested information about the business, but was refused. Then he sued to compel the management to submit the company's books to his inspection. Held, Sellers had a right to examine the books, for certain specific facts which he alleged to support his charges of fraud seemed at least to make his suspicions reasonable."[2] It has, therefore, been held that to entitle a stockholder to an inspection against the management's wishes, he must show reasonable and specific grounds for suspecting fraud or gross carelessness.

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1 See 10 Cyc. 958; 4 N. J. Eq. 392, 398; Matter of Steinway, 159 N. J. 250, 1 899.

2 Commonwealth v. Phoenix Iron Co., 105 Pa. 111.

The stockholders have no unlimited right to inspect the books of their corporation. Thus the certificate of the Steel Corporation says: "The board of directors from time to time shall determine whether and to what extent, and at what times and places, and under what conditions and regulations the accounts and books of the corporation, or any of them, shall be open to the inspection of the stockholders; and no stockholder shall have any right to inspect any account or book or document of the corporation except as conferred by statute or authorized by the board of directors, or by the resolution of the stockholders."

The usual remedy of a stockholder who has been denied the right to inspect corporate books is by petition for a writ of mandamus.[1] In a proper case, the court issues this writ against the custodian of the corporate records, commanding him to submit to the petitioning stockholder certain specified records. Also, the stockholder may sue to recover for damages which he may have suffered because of the denial. Laws have been passed imposing a penalty upon the custodian of corporate records who wrongfully refuses to allow a stockholder to examine them.

The New York statute says that the stock book must contain the stockholders' name, alphabetically arranged, with their places of residence, the number of shares held by each, the time when each became a stockholder and the amount paid on the stock held. It must be open daily, during at least three business hours, for inspection by any judgment creditor of the corporation or by persons holding or authorized by the holders of at least

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[1] 105 Pa. 111.

5 per centum of the outstanding shares. The corporation is subject to a penalty of $50., payable to the state, for every day during which it fails to comply with these requirements.[1]

Statutory Modifications

Under common law the stockholder could exercise this right only in good faith and for reasons connected with his rights as a stockholder. But when the right is given to the stockholder by statute, it is regarded as absolute and since the motive is immaterial he cannot be required to state his reasons. In New York a stockholder owning 3% of the capital stock may compel the corporation's treasurer to give him a sworn statement of its financial condition. In New York, South Dakota, and a few other states, the stockholders' rights of inspection have been greatly enlarged. The Alabama statute says that "the stockholders of all private corporations have the right of access to, of inspection and examination of, the books, records, and papers of the corporation, at reasonable and proper times." The stockholder, in states where laws like this are found, may examine the records without giving any reason, except when it is for an illegal purpose or is injurious to the corporation. Still, in some states the stockholders are required by law to give a substantial reason for examining the corporate books.

"The weight of American authority is to the effect that where the right is statutory, the stockholder need not aver or show the object of his inspection, and it is no defense under a statute granting the absolute right to inspection to allege improper purposes or that the petitioner

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1 "Law for Laymen", page 150, sec. 1011.

desires the information for the purpose of injuring the business of the corporation. A clear legal right given by a statute cannot be defeated by showing an improper motive. If this were so, the stockholder would be driven from a certain definite right given him by the statute, to the realm of uncertainty and speculation."[1] In New York, a court divided, three to two, held otherwise, but the decision seems open to question.[2]

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1 Venner v. Chicago City R. Co., 246 Ill. 170, 92 N. E. 643.

2 People ex rel. Britton v. Amer. Press Assn., 148 App. Div. 651 (N.Y.), 133 N. Y. Supp. 216.

EXTRAORDINARY RIGHTS

EXTRAORDINARY RIGHTS

Stockholder's suits are very important today because it furnishes a remedy whereby the minority stockholder may obtain relief against oppressive acts on the part of the directors or of the majority stockholders. The majority must govern and the courts have nothing to do with the internal management of the business. Also, the majority must act fairly and must pay reasonable heed to the rights of the minority, and if they act illegally, or unjustly the strong arm of equity will restrain them.

"The majority of the stockholders, as such, are not a trustee for the minority and do not stand in a fiduciary relation thereto."[1] On the other hand, the United States Circuit Court of Appeals for the Kansas District held that "the holder of the majority of stock of a corporation cannot lawfully sell to himself for its fair value the entire property of the corporation, when he knows that this price is only five-sevenths of the amount which the corporation can obtain for it from somebody else."[2] The sale was declared voidable at the election of the minority stockholders.

Right of Stockholder to Sue on Own Behalf

Under what circumstances a suit of this kind may be maintained is definitely established according to the Supreme Court of the United States.

"We understand the doctrine to be that to enable a stockholder in a corporation to sustain in a court of equity, in his own name, a suit founded

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1 Windmuller v. Standard Distilling & Distributing Co., 114 Fed. 491.

2 Wheeler v. Abilene Nat. Bk. Bldg. Co., 159 Fed. 391. See also Central Trust Co. v. Bridges, 57 Fed. 753.

on a right of action existing in the corporation itself, and in which the corporation itself is the appropriate plaintiff, there must exist as the foundation of the suit:

"Some action or threatened action of the managing board of directors or trustees of the corporation which is beyond the authority conferred on them by their charter or other source of of organization;

"Or such a fraudulent transaction completed or contemplated by the acting managers, in connection with some other party, or among themselves, or with other shareholders, as will result in serious injury to the corporation, or to the interests of the other shareholders;

"Or where the board of directors, or a majority of them, are acting for their own interest, in a manner destructive to the corporation itself, or to the rights of the other shareholders;

"Or where the majority of shareholders themselves are oppressively and illegally pursuing a course in the name of the corporation, which is in violation of the rights of the other shareholders, and which can only be restrained by the aid of a court of equity.

"Possibly other cases may arise in which, to prevent irremediable injury, or a total failure of justice, the court would be justified in exercising its powers, but the foregoing may be regarded as an outline of the principles which govern this class of cases."[1]

If a corporation proposes to buy a large block of stock in another corporation in an attempt to establish and maintain a monopoly of a

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1 Hawes v. Oakland, 104 U. S. 450, 26 L. Ed. 827.

certain business, have you as an individual stockholder a right to bring a bill of injunction to restrain this? The answer is yes.[1]

A minority stockholder has the right to sue on his own behalf to restrain ultra vires acts of the directors or a majority of the stockholders. Also, he may sue in equity to restrain fraudulent and oppressive acts of the majority. Whenever a stockholder has been wronged by the corporation, the judgment must be against the corporation itself.[2] "Where a railroad corporation subscribed, or rather proposed to subscribe, the sum of one thousand pounds to the British Imperial Institute, it was held that a single stockholder, who dissented from this, could appeal to equity for an injunction to restrain this unauthorized expenditure of the funds."[3] Any shareholder may come into equity and say in his petition, "This company is going to do an act which is beyond its powers; stop it," and the court must issue an injunction, if the act done is outside the powers of the company.

A leading case to illustrate the right of stockholders to sue on their own behalf is given below:

"Plaintiff alleged he was the owner of seven shares in the company, all of which were fully paid; that there were 131 shares of $500 each, none of which (except plaintiff's shares and one other) were more than half paid up. Under authority it was determined to increase the stock

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1 Bigelow v. Calumet & Hecla Min. Co., 155 Fed. 869.

2 Dousman v. The Wisconsin & Lake Superior Min. & Smelting Co., 40 Wis. 418.

3 Tomkinson v. S. E. R. Co., L. R. 35 Ch. Div. 675 (Eng.).

to 1,000 shares, of which 250 were to be used in performing a contract with another corporation, 95 shares reserved to the company, and the other 655 shares issued to the shareholders,--five shares fully paid for each share of the old stock. Plaintiff alleged that the company refused to allow him any greater interest for his fully-paid shares than was allowed to a like number of half-paid shares; he asked that he be allowed new shares, in proportion to the amount paid, or that half of those issued to holders of half-paid stock be canceled. The facts were found as alleged, and further distribution was enjoined, unless the issue of the new shares were made in proportion demanded by plaintiff.

"Ryan, C. J. 1. The injury which the respondent, as a shareholder of the appellant, sets up in his complaint, is one peculiar and personal to himself, not common to other shareholders, alleged to have been committed by the board of directors, as the governing body of the corporation; that is, by the corporation itself. Clearly his remedy is against the corporation. Probably he might have maintained an action at law against it. Gray v. Portland Bank, 3 Mass. 364. But the effect of such an action would be to convert part of his interest as a shareholder into a judgment for damages; in other words, to sell a portion of his stock to the corporation. That he is not obliged to do. He has a right to maintain his proportionate interest in the corporation, certainly as long as there is sufficient stock remaining undisposed of by the corporation. Trading corporations of the character of the appellant have been likened to partnerships, and the remedies of stockholders to those of partners, by very high authority. Gray v. Portland Bank, supra; Robinson v. Smith, 3 Paige 222; Adley v. Whitstable Co., 17 Vesey 315. And equity has always afforded a remedy to a stockholder, in such a case as this, by injunction, account, or other appropriate decree. Adley v. Whitstable Co., supra. This principle has been repeatedly recognized in this court, as in Putnam v. Sweet, 2 Pin. 302; Nazro v. Ins. Co., 14 Wis. 319.

"Such a case is clearly distinguishable from suits by stockholders in the right of the corporation, founded on wrongs against the corporation. In that class of cases, as the authorities cited by the appellant show, the right of suit is primarily in the corporation itself; and stockholders take the right, in lieu of the corporation, only upon refusal of the governing body of the corporation to sue.

"Here the wrong complained of is by the corporation, not against it. The right is against it, not against individual directors. The judgment, to be effectual, must be against the corporation itself; not against the directors personally, who may be changed from time to time. And even where a suit would lie by a corporation against its governing body for wrongs done against it by the governing body, it is sufficiently manifest that a demand upon the governing body to bring the suit would be nugatory.

"2. If there are other shareholders in like condition as the respondent, their right and his are several; they may bring their separate suits, or they may submit to the wrong at their several pleasure. The respondent has no right to represent them. The case is entirely distinguishable from a wrong done by the governing body common to all the stockholders.*** Affirmed."[1]

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[1] Dousman v. The Wisconsin and Lake Superior Mining and Smelting Company. 40 Wis. 418.

Right of Stockholder to Sue on Behalf of the Corporation

One of the most important extraordinary rights which the stockholder possesses is to invoke the aid of a court to prevent unlawful acts by corporate officers or to correct such acts if they have been performed without his assent. The court will not act if it an unlawful act, which a majority of the stockholders could not ratify and confirm, and if the complaining stockholder has not used every reasonable effort to induce the corporation through its proper officers to prevent or correct the act.[1] The stockholder would be relieved of this effort if the wrongdoers were majority stockholders or known to be in collusion with them. If a stockholder assents in an unlawful act and later sells his stock to a person who did not know of the acquiescence, the latter may bring an action in court to have the acts corrected. In case a stockholder is damaged by an act of the corporation, he has the privilege to bring action against the corporation because it is an entity separate from any of its stockholders. Therefore, the majority of the stockholders can not act unlawfully to the detriment of minority stockholders, even though the majority occupies no fiduciary position toward the minority and has unlimited discretionary power if it keeps within the law.

"A shareholder may interpose and set the machinery of law in motion for the protection of corporate rights or the redress of corporate wrongs, when the corporate management, after proper demand, fails to act in the matter."[2]

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1 Continental Securities Co. v. Belmont, 206 N. Y. 7, 99 N. E. 138.

2 36 Fed. Rep. 627.

"Equity will not entertain a bill by stockholders to remedy wrongs committed by the officers of the corporation, where such stockholders have not applied to the corporate authority to remedy such wrongs.[1] A stockholder may maintain an action to restrain the corporation from acts in excess of its corporate authority;[2] but he cannot maintain a bill to enjoin the wasting of corporate property unless the corporation itself refuses to bring action in which case it must be made a party defendent."[3] "A corporation is a necessary party to a suit by stockholders for the enforcement of its rights."[4]

Ultra Vires Transactions

In this section a few cases will be given where the corporate management is undertaking things which are beyond the company's powers. If there is any misapplication of the company's funds there is a breach of trust, and a shareholder may bring suit to enjoin it, because when a person becomes a shareholder he invests his property to be employed in a certain enterprise specified in the corporate charter.

"The Cherokee Iron Company was chartered to manufacture pig iron. The directors undertook to erect and operate a corn and flour mill. Jones, one of the stockholders, filed a bill in equity to enjoin the use of the corporate funds for such purposes. The court granted the injunction and

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1 87 Tenn. 771; 31 W. Va. 798; 127 U. S. 489; 54 Fed. Rep. 985.

2 75 Ia. 722.

3 54 Fed. Rep. 216.

4 149 U. S. 473.

held that the erection and operation of a flour and corn mill was ultra vires, unlawful, and a breach of trust."[1]

"The Iowa City Gaslight Company was chartered to manufacture gas, coke, and coal tar. It agreed to supply Iowa City with electric light. Carson was a stockholder in a rival corporation which had been organized for the express purpose of supplying Iowa City with electric light. Carson subsequently acquired a number of shares of stock of the Iowa City Gaslight Company and filed a bill in equity to enjoin the execution by that company of its ultra vires contract to supply Iowa City with electric light. Held, as a stockholder he was entitled to such relief."[2]

Fraudulent or Oppressive Acts

Where the board of directors contemplates or does anything of a fraudulent or oppressive nature in connection with some third person or corporation, or among themselves, or with other stockholders, and serious injury is threatened to the corporation, or to some of the stockholders, a stockholder has a right to relief.

"In 1845 the State of Ohio chartered the Commercial Branch Bank. The charter provided the basis or average upon which the property of the bank was to be taxed. In 1852 the state passed a law which raised the average of taxation of the bank's property. The directors of the bank, although often requested to do so, refused to resist the collection of the

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1 Cherokee Iron Co. v. Jones, 52 Ga. 276.

2 Carson v. Iowa City Gaslight Co. 80 Ia. 638.

tax. Woolsey, a stockholder of the bank, filed a bill in equity against the bank and Dodge, the tax collector, for an injunction to restrain the collection of a tax levied under the authority of the act of 1852. The court granted the injunction and held that the inaction of the directors of the bank amounted to a breach of trust."[1]

"The New York Steamship Company was chartered by the State of New York to run steamships between New York City and Norfolk, Virginia. While the company was prospering, a majority of its directors, in order to serve their own interests and to ruin the company, fraudulently sold a number of its steamboats to a rival concern for a compensation far below their value. The board of directors and a majority of the shareholders, although requested to do so, refused to take any steps to avoid the sale. Gray, a stockholder, sued to have the sale set aside. Held, the sale should be declared void."[2]

"The Thaddeus Davids Company, whose capital stock was only $30,000, paid its president a yearly salary of $20,000. Of this sum he retained $2,500 for his services and turned over the remainder to three other stockholders. After the president's death, three of the stockholders, who composed the board of directors, voted the president, the secretary, and the treasurer each a salary of $8,000 and then elected themselves to these offices. Such large salaries more than ate up the profits of the business.

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1 Dodge v. Woolsey, 18 Howard (U.S.) 331.

2 Gray v. New York Steamship Co., 3 Hun (N.Y.) 383.

The services rendered by the president were purely nominal, while those of the secretary and the treasurer were worth in each case about $2,000 a year. The plaintiff, a minority stockholder, sued to compel the officers to return the moneys received by them under the name of salaries. Held, the defendants must make restitution, for the voting of such exorbitant salaries was a fraud."[1]

"The Saxonian Manufacturing Company was chartered under New Jersey laws with $20,000 capital stock, there being 200 shares of $100 par value. Fifty shares, full paid, were issued to Knoop; 48 shares to his wife; 50 shares to Bohmrick's wife; and one share to a man who was under Bohmrick's domination. To Bohmrick were issued the remaining 51 shares, for which he promised to pay. Thus Bohmrick and his wife were majority stockholders and controlled the corporation. Knoop repeatedly urged Bohmrick to pay for his shares, but the latter failed to do so. Knoop then filed a bill in equity to compel Bohmrick to make payment. Held that Bohmrick's refusal to pay was a fraud perpetrated by him under cover of his power to control the corporation. Knoop was entitled to the relief which he sought."[2]

Merger or Consolidation

The charter of a corporation involves a contract among the original members. Any change in the contract should be submitted to the stockholders for their approval.

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1 Davids v. Davids, 120 N. Y. Supp. 350.

2 Knoop v. Bohmrick, 49 N. J. Eq. 83.

Is the assent of all the stockholders of a corporation necessary to effect a merger? The protection of the United States Constitution, forbidding the states to impair contractual obligations, extends to each and every stockholder, and before general enabling statutes were passed by the several states, the unanimous assent of the stockholders was a necessary condition precedent to merger. This remains true to-day as to most corporations created before such statutes were passed.

"In 1884 the legislature of Kentucky passed an act authorizing the Simpsonville Turnpike Company and the Fisherville Turnpike Company, both Kentucky corporations, to merge. The act provided that when the agreement of the directors of both companies should be ratified by a majority of the stockholders of both companies, the consolidation would be completed. When the two corporations were created, there was no law in the state reserving the power to alter or amend their charters, nor was there any provision in the charters concerning consolidation. Botts, a stockholder of the Simpsonville Turnpike Company, sued to prevent the consolidation. Held, that the consolidation of the two corporations was a departure from the scope of their charters, and that the unanimous assent of the stockholders was necessary. The act of 1884 was an infringement of the stockholders' original contract and therefore void. The merger was forbidden."[1]

"In 1866 the State of Michigan incorporated the Grand Trunk Railroad Company. Tuttle was one of the subscribers to the stock, and part of his

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1 Botts v. Simpsonville Turnpike Co., 88 Ky. 54.

subscription remained unpaid. The state had not, either by law or in the charter, reserved the right to alter or amend. In 1870 an act was passed authorizing the consolidation of the Grand Trunk Railroad and the St. Joseph Valley Railroad Company. Tuttle refused to assent to the consolidation. The companies, however, joined forces and formed the Michigan Air Line Company, which, under the above-mentioned act, succeeded to the rights of the two constituent companies. The new corporation then called in the unpaid stock subscriptions of the old companies, and sued Tuttle, who refused to pay. <u>Held</u> that the law of 1870 which authorized consolidation without the assent of all the stockholders was a violation of the original contract among the stockholders; that the consolidation was therefore null and void; and that Tuttle was not liable."[1]

Most of the states have reserved the right to alter or amend the charters of corporations, since the decision of the United Stated Supreme Court in the famous Dartmouth College Case. Since the majority of the companies are subject to the modern laws any alteration in the charter of a corporation, even though some stockholders oppose it, is not necessarily a violation of the United States Constitution.

"A railroad corporation purchasing the stock of a competing corporation cannot obtain control of its affairs, divert the income of its business, refuse business which would enable it to pay its interest, and then institute proceedings in equity to enforce the interest-bearing obligations for the

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1 Tuttle v. Michigan Air Line Co., 35 Mich 247.

avowed purposes of obtaining control of its property to the injury of the minority stockholders. The controlling company will become, for all practical purposes, the corporation which it controls, and bears the same trust relations to the minority stockholders of the latter that usually exists between stockholders of a corporation itself."[1]

An authority, from whom we have already quoted, says that nothing can be more unjustifiable and dishonourable than an attempt on the part of those holding the majority of the shares of a corporation to place their nominee in control of the company and then to use their control for the purpose of obtaining advantages to themselves at the expense of the minority. This principle was applied in the case of two railroad companies, whose lines connected with a third company, bought a controlling interest in its stock and elected a number of their own agents directors. They proceeded at once to make contracts between this company and the other two which were injurious to the minority interest of the third company. The Sumpreme Court of New Hampshire, where this contention arose, held that the third company whose management has thus been changed had an absolute right to refuse to be bound by the transactions, whether the contract was fair or not. Cases are constantly occurring in which the majority in interest take advantage of their position to wring or injure the minority interests, and the courts need to be vigilant in thus guarding the interests of the minority against raids made by those who are in control.

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1 Farmers' L. & T. Co. v. N. Y. & No. R. Co., 54 Alb. L. J. 311 (Ct. of App. N. Y.)

Conditions of Suit

"In a stockholder's suit brought on behalf of the corporation, the corporation is a necessary party defendent. The misconducting directors must also be parties. The corporation is, in substance, though not in form, the plaintiff. It is not regarded as such, however, for the purposes of federal jurisdiction. Where the stockholder sues in behalf of the corporation, he must show a cause of action in favor of the corporation with the same detail of facts as would be proper in case the corporation itself had brought the action. He must also show, definitely and clearly, the facts which entitle him to maintain the action on behalf of the corporation. He must usually, therefore, allege and show that he tried to have corporate action taken through the proper corporate agency, to have the wrong righted, and that they refused; or that the wrongdoers were the corporate officers themselves, who had authority to have the corporation sue. If the offense charged is one that the stockholders could ratify, the courts will not interfere until they have been called together in a stockholders' meeting to pass upon the question,--unless delay would fatally endanger the plaintiff's rights. Negligent or disloyal acts of the directors or officers may be ratified. The stockholders may conclude that after all, the transaction is for the benefit of the corporation. Ultra vires acts, however, cannot be ratified."[1]

The stockholder must sue on behalf of himself and all the other stockholders, as representative of their collective rights.

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1 Foss v. Harbottle, 2 Hare 489 (Eng.)

Who Can Sue

"A stockholder acquiring his shares of stock subsequent to the transaction complained of, may maintain an action of this character."[1]

In Illinois and in the federal courts, a different rule prevails. "Sound reason and good authority sustain the rule that a purchaser of stock cannot complain of the prior acts and management of the corporation."[2]

"A transferee of stock cannot sue in regard to transactions acquiesced in, or assented to, by his transferor. He holds the stock by the same title and has no greater rights than his predecessor."[3] In Alabama, however, it is held that a bona fide assignee of an assenting shareholder may sue.

Federal Equity Rule

Equity Rule No. 94 was announced by the United States Supreme Court in 1882. In November, 1912, Equity Rule No. 27 was made known. This rule governs stockholders' bills in the federal courts, where most of these actions are brought. It reads: "Every bill brought by one or more stockholders in a corporation against the corporation and other parties, founded on rights which may properly be asserted by the corporation, must be verified by oath, and must contain an allegation that the plaintiff was a shareholder at the time of the transaction of which he complains, or that his share had devolved on him since by operation of law, and that the suit

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1 Pollitz v. Gould, 202 N. Y. 11, 94 N. E. 1088.

2 Home Fire Ins. Co. v. Barber, 67 Neb. 644, 93 N. W. 1024.

3 Babcock v. Farwell, 245 Ill. 14, 91 N. E. 683.

is not a collusive one to confer on a court of the United States jurisdiction of a case of which it would not otherwise have cognizance. It must also set forth with particularity the efforts of the plaintiff to secure such action as he desires on the part of the managing directors or trustees, and, if necessary, of the shareholders, and the causes of his failure to obtain such action, or the reasons for not making such effort." [1]

Defenses

A stockholder's suit brought in equity is subject to all the defenses, and governed by all the rules, of an equitable action. Unreasonable delay will create a bar to the action. Acquiescence is a defense and shows that the shareholder bringing the action is suing as the mere puppet of a rival corporation. Where the complainant sues bona fide in his own interest, and merely his motives are questionable, the action is generally held to lie. A similar prior suit brought by another stockholder and decided against him is res adjudicata. To show that a plaintiff is not really a stockholder, as where his stock is fictitious or void, is also a defense.

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1 Modern American Law, p. 260.

SUMMARY

SUMMARY

Every stockholder of a corporation has certain rights incident to his status as a stockholder. Such rights are not particularly the rights of a minority stockholder. That is to say, a stockholder merely because he is a stockholder, has certain privileges because of his holding of stock which he can assert no matter who controls the corporation. These privileges, strictly speaking, are not rights peculiar to minority stockholders; they belong to all stockholders.

It was unnecessary to discuss every conceivable right which a stockholder may possess because he owns a share of stock. Many rights are provided for in the articles of association and by-laws. We will review here the important rights which are frequently breached to the detriment of a minority stockholder.

The important rights of stockholders are: (1) Right to be present at meetings, (2) Right to transfer stock, (3) right to participate in profits, (4) right to subscribe to increase in stock, (5) right to share in assets upon dissolution, and (6) the right of inspection.

Listed above are only those rights which a minority stockholder has in common with all stockholders, of which he as an individual stockholder might be deprived, and which he can enforce for his own personal benefit. Next, there are the rights which all minority stockholders have, which protect them against the domination of the majority. These rights enable a minority stockholder in certain circumstances to complain of the action of the majority, that is, the action of the corporation. For the action of the majority is the action of the corporation.

It may be said in general that the courts sometimes hesitate to interfere with the management of a corporation. If it were otherwise, the dockets of the courts would be crowded with the complaints of disgruntled stockholders.

There are three main classes of cases where minority stockholders may obtain relief from the acts of the majority, namely, where such acts are illegal, where they are outside the corporate powers, and where they are fraudulent or oppressive.

A few instances of fraudulent action is (1) voting excessive salaries, (2) obtaining inequitable contract, (3) fraudulently favoring competitor, (4) refusal to declare dividends, (5) wrongful transfer of entire assets, (6) watered stock, (7) fraudulent reorganization, and (8) fraudulent dissolution.

CONCLUSION

CONCLUSION[1]

While it is true that the law, in order to protect the minority stockholders of a corporation from the wrong doing, fraud, or oppression of the majority, has imposed various obligations upon the majroity, and has given to the minority corresponding rights, yet the courts are inclined to favor leaving the internal management of a corporation to those whom the stockholders have chosen to direct it. This attitude is the correct one where no serious damage would result, for otherwise competitors could easily make all sorts of trouble for any corporation.

For this reason many of the rights of minority stockholders are more of theoretical than of practical value, and not listed in this paper. The machinery of the corporation frequently favors the organized majority, as proxies may be mailed by those in control to indifferent stockholders who sign and return them without investigation. So in purchasing stock in a corporation one should rely principally upon the integrity and ability of the directorate and officers.

1 See Gleick, H. S., M. A. L.

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