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Corporations—Merger—Right of Holder of Cumulative Preferred Stock to Accrued Dividends

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national conditions may lead the courts to validate extended indirect inva-
sions of the immunities contained in the Bill of Rights. Subsequent decisions
will reveal whether this undesirable possibility will be actualized.

J. R. S.

CORPORATIONS—MERGER—RIGHT OF HOLDER OF CUMULATIVE PREFERRED
STOCK TO ACCRUED DIVIDENDS—[Delaware].—A corporation, by vote of
91.8% of its total stock, adopted a plan to merge with its wholly owned
subsidiary. Under the plan one share of $3 cumulative preferred stock and
six shares of no par value common stock in the new company were to be
exchanged for each share of the old $6 cumulative preferred stock and $29
accrued, unpaid dividends. The parent corporation had at the time a sur-
plus, unearned but available for dividends, which was more than sufficient
to pay the accumulated preferred dividends. This surplus was to be capital-
ized and given to the preferred stockholders. Delaware statutes existing at
the time the corporation was created authorized the merger of parent cor-
poration with subsidiary and the adoption of a plan for converting the stock
of the old corporation into that of the new. Such a plan had to be adopted
by a two-thirds vote of all stockholders and all "rights of creditors * * * all
debts, liabilities and duties" and "all the restrictions, disabilities and duties
of each" were to survive against the resulting corporation. The plaintiffs,
holding shares of the old $6 cumulative preferred stock, brought a bill in
equity to have the merger declared void insofar as it would convert their
stock into other securities without paying the accrued dividends. Held, that
the merger statute, which was automatically a part of the contract between
stockholder and corporation, authorized two-thirds of the stockholders at
any time to effect a merger and to alter, under a fair and equitable plan, the
rights of preferred stockholders to accumulated unpaid dividends as well
as to future preferences. Plaintiffs were also held to be barred by laches.

The court's task was to construe the merger statute to determine whether
the legislature had intended to foster mergers to the extent of allowing the
corporation to make a fair and equitable adjustment of existing claims by
commuting accrued dividends into common stock rather than compelling
literal compliance with the terms of the stock contract. In previous cases,
where the changes had been attempted under a statute authorizing charter
amendments, the same court had refused to allow abrogation of the right
to preferred cumulative dividends already accrued, but did allow it as

sible unpredictable judicial action serves only to emphasize that the courts
cannot be relied upon as the bulwark of civil liberties and that preservation
of civil liberties fundamentally rests upon the vigilance of the citizenry
acting through the legislature.

4. Literal compliance with the terms of the contract would require pay-
ment of all accrued dividends before any other class of stockholders might
participate in profits.
COMMENT ON RECENT DECISIONS


9. The amendment statutes before the court in Consolidated Films Industries v. Johnson (Del. 1937) 197 Atl. 489 authorized "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." Del. Revised Code (1935) sec. 2058. The merger statute merely authorizes an agreement prescribing "the manner of converting the shares of each of the constituent corporations into shares of the consolidated corporation," and furthermore provides that the resulting corporation is to be "subject to all the restrictions, disabilities, and duties of each of such corporations so consolidated or merged" and that all "rights of creditors *, * *, and all debts, liabilities and duties of the respective constituent corporations shall thenceforth attach to said resulting or surviving corporation * * *." Del. Revised Code (1935) secs. 2091, 2092.

10. But these considerations do not apply in the instant case since the parent corporation merged with its wholly owned subsidiary and no capital reconstruction was necessary. In the original trial of the case the chancellor had held that the scheme was not a true merger but a mere reclassification of shares. "If what the defendant did will stand the test of legal legitimacy, * * * all a corporation needs to do to escape the results of the law as laid down by our Supreme Court, is to create a subsidiary for itself and then proceed to absorb it by merger." Havender v. Federal United Corp. (Del. Ch. 1938) 2 A. (2d) 143, 147, aff'd (Del. Ch. 1939) 6 A. (2d) 618.


claim to participate in future profits in advance of common stockholders. 12
The dispute is essentially one between preferred and common stockholders
over the distribution of future profits. To force the preferred stockholder
to relinquish his preferred rights and assume the status of a common stock-
holder is, of course, to deprive him of a valuable security device. On the
other hand, the preferred stockholder receives in lieu of cash the equivalent
of a stock dividend, which can be converted into cash if there is a ready
market.

The court emphasized the point that the merger plan was fair and equi-
table. For the plan to be fair and equitable to the preferred stockholders,
it should give compensation for their contract rights to priority in the dis-
tribution of future profits. 13 On the other hand, since the profits have not
been, and may never be, earned, they are not entitled to be paid the full
arrearages in cash. An equitable plan would compensate them for loss of
priority in the distribution of dividends by giving them a greater propor-
tionate share through ownership of common stock. The court has assumed
the difficult task of determining whether the amount of stock given is a
fair settlement, taking into consideration the situation of the company
and its prospects for future profits. 14

W. B. W.

FEDERAL PRACTICE—RAISING NEW ISSUES ON APPEAL—BOARD OF TAX
APPEALS—[Federal].—The Commissioner of Internal Revenue, applying
section 166 of the Revenue Act of 1934, 1 held taxable the income from
three irrevocable short-term trusts executed by the taxpayer for the bene-
fit of his children. On appeal by the taxpayer to the Board of Tax Appeals,
the Commissioner relied on sections 166 and 167 of the Revenue Act of
1934. 2 The Board entered its decision, holding that there were no deficiencies
in the return of the taxpayer. The Commissioner appealed to the Supreme
Court, assigning error in the Board’s application of sections 166 and 167,

13. In the typical situation, the preferred stockholder has had to forego
his dividends during times of depression. When business has improved, he is
asked by the common stockholders to give up his priority rights so that
they may share immediately in profits. Unless the clearing away of arrear-
ages attracts further capital investment which increases profits, such a
plan benefits the common stockholders at the expense of the preferred.
14. In the instant case it would seem that the preferred stockholders were
adequately protected. The unearned surplus existing at the time of the
merger was capitalized and given to them. The fact that a large majority
of the preferred stockholders voted in favor of the plan should not, however,
be given too much weight in determining the question of fairness of the
settlement. Many of the preferred stockholders probably held common stock
which they hoped to benefit thereby. Furthermore, the management, usually
a large holder of common stock, has a tremendous influence through the
solicitation of proxies. See Note (1937) 4 U. of Chi. L. Rev. 645.

166, 167, and 22 (a).
2. Jay C. Hormel (1939) 39 B. T. A. 244.