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RIGHTS OF STOCKHOLDERS IN THE NEW YORK COURTS

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The corporate form during the past century has become simply a business device readily available to all, although historically the creation of a corporation, with the spelling out of its stockholders' rights, was a deliberate act of a sovereign power. This new freedom has resulted in the formation of a great variety of corporate structures and the formulation of charter provisions frequently seeking to nullify the interests of those most concerned—the investors.

This article will analyze the "bundle of rights" which the stockholder receives in return for his capital contribution and will study the extent to which he is able to enforce these rights in court. The latter examination will be confined to the decisions of a single year—1946, for one state—New York, the forum for most corporate litigation, and will concentrate on recurrent corporate problems.

The Stockholder's Right to Manage Corporate Affairs

I

The principal right of stockholders is collectively to manage the corporation by voting at the election of directors, except where the stockholders have surrendered that right, an exception which unfortunately has become very extensive. The investing public, in some cases by accepting non-voting stock or stock subject to a voting trust, in others by accepting stock with disproportionately small voting powers, has made the capital contribution in exchange for engraved sheets of paper of scarcely more value, from the management standpoint, than the chips or counters used in children's games.

There is little that can be done to help those who have surrendered to promoters—without consideration—their right of management, the principal right originally exchanged for the contribution of capital.

* The following article is the substance of an address delivered on April 1, 1947, under the auspices of the Committee on Post Admission Legal Education of the Association of the Bar of the City of New York. A report of the address also appears in 117 N.Y.L.J. 1648 et seq. (April 28-May 2, 1947).
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1. Significant both for law and practice are many court decisions which never reach the Reports and hence never reach the digests usually employed by lawyers. In New York decisions of the Supreme Court for the counties in and around New York City are printed in the New York Law Journal, a daily newspaper. The proportion of Law Journal decisions which reach the printed reports in Miscellaneous or New York Supplement is larger for corporate than non-corporate decisions, but approximately half are still to be found only in the Law Journal. Of 155 corporate decisions which I have noted for the year 1946, 74 were Law Journal opinions not otherwise reported.
Only in the gas and electric utility companies has the Federal Government found a basis for compelling changes in existing corporate structures which "unfairly or inequitably distribute voting power among security holders." 2

There have also been a few recent isolated efforts to prevent the issuance of non-voting stock, but these restrictions look only to the future and are limited to securities listed on the New York Stock Exchange, 3 to investment companies, 4 to corporations reorganized under the Chandler Act, 5 or to corporations in Illinois and North Carolina. 6 In all other instances the various devices invented to protect the management against ouster have received the sanction of court and state, and are now classified as "legal devices" for the separation of ownership and control.

With the exceptions noted, the law permits a stockholder to surrender forever his right to vote; but if he gives it up temporarily—by way of a voting trust—the law solicitously steps in and prescribes the maximum period, usually 10 years. 7 During the period set for the voting trust, the power given the voting trustees is irrevocable. What can be done if the voting trustees are reluctant to give up their powers after the period set by the Voting Trust Agreement has run out? In the only such case in New York during the past year, the court gave relief by compelling the voting trustees to give proxies to the beneficial owners, thus enabling them to elect a new set of Directors. 8

A deliberate surrender of the individual holder's normal rights with respect to his stock is sometimes effected by a written agreement signed by all the stockholders of a corporation—a situation which can arise only in a "close" corporation (a short-hand designation for a closely-held enterprise). During the past year, such agreements were disclosed in six cases, and in all, none of which went up on appeal, the stockholders' agreement was enforced. Five of these cases involved restrictions

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3. The New York Stock Exchange in a printed statement, dated May 4, 1940, reported that since 1926 it has refused to list non-voting common stock.
4. Investment Company Act § 18(i), 54 Stat. 817, 15 U.S.C. § 80a-18(i) (1940) (requiring that in the capital structure of any investment company set up after the date of the Act every share of stock must have voting rights).
6. Denial of voting power to any class of stock is prohibited in Illinois by statute (Ill. Bus. Corp. Act § 14) and in North Carolina by judicial decision. Sheppard v. Rockingham Power Co., 150 N.C. 776, 64 S.E. 894 (1909), and cases therein listed.
7. N.Y. Stock Corp. Law § 50.
on the alienability of stock. The sixth alone involved voting rights. In this last interesting case, Special Term (the motion part of the Supreme Court) upheld the sufficiency of a complaint by a 25% stockholder who, on the basis of a stockholders' agreement assuring her one director, had asked that the other stockholders be required to cast their votes for her choice of one director. Thus, despite the pall cast on stockholders' agreements by the decision in *Benintendi v. Kenton Hotel, Inc.*, these agreements, when properly limited, continue to be upheld.

In cases where the right to vote remains unimpaired in the stockholders, a variety of problems may be presented for judicial determination. The seven applications to regulate or test corporate elections considered by the New York courts in 1946 are illustrative.

One of these cases, the only one to reach the Appellate Division, posed the question of who has the right to vote, the owner of stock or a person to whom it has been pledged. The appellate court held that the right remains vested in the owner where there is no express agreement to the contrary. Two decisions involved the calling of a special meeting of the stockholders. In one case, the court refused to call a special meeting, duly requested in accordance with the by-laws, because a regular meeting was scheduled to take place in a month anyway. In another case, the court refused to enjoin the holding of a special meeting, saying that...

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9. Oppenheim Collins & Co., Inc. v. Beir, 187 Misc. 428, 64 N.Y.S.2d 19 (Sup. Ct. 1946, Schreiber, J.); Ionic Shop, Inc. v. Rothfeld, 64 N.Y.S.2d 101 (Sup. Ct. 1946, Hecht, J.); In re Block's Will, 186 Misc. 945, 60 N.Y.S.2d 639 (Surr. Ct. 1946, Henderson, Surr.); Estate of Alfred Jacobs, 115 N.Y.L.J. 696 (Surr. Ct. Feb. 20, 1946, Delehanty, J.); Peets v. Manhasset Civil Engineers, Inc., et al., 68 N.Y.S.2d 335 (Sup. Ct. 1946, Livingston, J.). In the case last cited, the court later held that the restriction on alienation in a stockholders' agreement cannot be availed of by one who was not a stockholder at the time of the agreement, who was not a party to it, and whose acquisition of stock after the date of the agreement was directly from the corporation which had also not been a party to the agreement. The court pointed out that neither the certificate of incorporation, the by-laws, nor the stock certificates contained any reference to the agreement between the original stockholders. Peets v. Manhasset Civil Engineers, Inc., 68 N.Y.S.2d 338 (Sup. Ct. 1946, Stoddart, J.).


11. 294 N.Y. 112, 60 N.E.2d 829 (1945). This important decision by the New York Court of Appeals ruled that an agreement signed by all stockholders (1) may provide that the by-laws may be amended only by unanimous vote of the stockholders, (2 and 3) may not provide that no stockholders' resolution should be adopted, or directors be elected, except by unanimous vote of the stockholders, and (4) may not provide that no resolution of the directors should be adopted except by unanimous vote of the directors. Three of the seven judges in the Court of Appeals dissented from the holding that the provision numbered 4 in the above list was improper, but concurred in the rulings on the other questions presented.


nothing harmful could occur at the meeting since the stockholders were evenly divided.¹⁴

Four cases involved the court's power, under § 25 of the General Corporation Law, to set aside an election of directors. In one, the court set aside the election.¹⁵ In another, a referee was asked to report whether the meeting had really been held and whether the petitioner had received prior notice of the meeting.¹⁶ In a third, the court refused to set aside the results of a special meeting because, said the court, it would be futile: the complainants, as minority stockholders, could achieve nothing even were a new election ordered.¹⁷ In a fourth case, a "foreign corporation" was involved. The New York court declined to take jurisdiction despite the fact that the corporation's principal place of business was in New York and all of the individual defendants were residents there.¹⁸

The power to vote for directors has been described by the New York Court of Appeals as the stockholder's "supreme right and main protection."¹⁹ With only one exception, however, every case on this subject in New York in 1946 involved a family or "close" corporation, and a "close" corporation is usually a small one. In the case of large corporations, this important question is too often put beyond the reach of the court when the corporation is first organized.

II

A second feature of the stockholder's right to manage the corporation is his right to inspect the corporate books—ordinarily to ascertain the true value of his stock, to gauge the success and honesty of the corporate managers, or to learn the names of his fellow stockholders. But as in the case of the right to vote for directors, the surrender by prospective stockholders of their right to inspection is often arranged by the promoters and their attorneys when the corporation's charter is drafted. This practice was dramatically illustrated in 1946 by the statement of a vice-president of General Motors Corporation who declared, when the UAW (CIO) wanted to examine the books of that corporation: "We don't even open our books to our stockholders."²⁰

The charter of General Motors does contain a provision reading as follows:

"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 a resolution of the stockholders."

A recent study of 100 of the country's very large corporations showed that all but two of the twenty-seven incorporated in Delaware contained in their charters or by-laws a limitation similar to the "no inspection" provision quoted above. These statistics are especially interesting because even the Delaware courts have declared this provision invalid.

Why, then, does the draftsman continue to include in a corporate charter a provision which the courts have declared void? I suspect it is for use on a stockholder or his attorney who does not realize the invalidity of the charter limitation.

The right to inspect—which the courts do not permit to be waived—is a common law right, existing independent of statute. Statutes on the subject, although they frequently appear, are rarely utilized because the common law right is much more extensive. Under the New York statutes, for example, to compel inspection of a list of stockholders, a stockholder must either own 5% of the stock or if he is a smaller stockholder, must have been a stockholder for at least six months; to require a financial statement a stockholder must own 3% of the stock. None of these prerequisites applies when the application is based upon the stockholder's inherent common law right. Nor, as is widely believed, need the application to inspect be made in conjunction with a stockholder's suit; the information may be and most often is sought by an application in the nature of mandamus, in New York under Article 78 of the Civil Practice Act.

During 1946 there was one application for a financial statement—sought under Article 78 of the Civil Practice Act, which was not submitted pursuant to Section 77 of the Stock Corporation Law because the petitioner had already had one statement within the year. The respondent wisely offered to permit an inspection, which the petitioner

24. N.Y. Stock Corp. Law § 10.
25. Id. § 77.
declined because of the expense. The court thereupon, and, I believe, properly refused to order a second financial statement.22

During the past year there came to my attention no less than fifteen applications by stockholders, under Article 78,22 seeking a general inspection of corporate books. Special Term immediately ordered the full inspection on most of the applications, covering both large and small corporations.23 Of the decisions granting an inspection, only three went to the Appellate Division, and all three were affirmed without opinion.23 One of the rulings so affirmed was made by Judge Hofstadter who had said: “The instant case is another illustration of the familiar situation in modern business, where a minority stockholder discovers that the prosperity of a corporation, for some unknown reason, does not redound to his personal advantage.” The Judge ruled that the stockholder was entitled to inspect the books and learn the reason for the “failure of the corporate affluence to trickle through to its stockholders.”23

In a fourth case to reach the Appellate Division, the lower court had refused to permit an inspection because the respondent charged that the petitioner sought “a fishing expedition” to discover something on the basis of which suit might be instituted. The denial of the application was promptly reversed by the Appellate Division.31

Since almost the only basis for the court’s refusing an inspection is that the petitioner is not acting in good faith, this defense is interposed in almost every litigated application. During the past year it was pleaded in opposition to an application made on behalf of the owner of a 50% stock interest which the petitioner had inherited from her father.

Since the applicant had never been anything but a housewife, the court

found it difficult to see upon what ground bad faith could be predicated, and forthwith granted an inspection. The incident, however, illustrates the ubiquity of this defense. Where there appears to be any substance to this objection, the court orders a preliminary trial on the issue of petitioner's good faith. However, there has not come to my attention a single decision during the past year in which the defense of petitioner's lack of good faith caused an examination to be denied, although in one case this objection did result in the inspection's being limited.

Only in two of the fifteen applications was a general inspection of the books completely denied; in one case the court found that jurisdiction was lacking over the defendant, a foreign corporation; and in the other, the petitioner's desire to see the books was admittedly not motivated by her interest as a stockholder but solely by her expectation of information for use in a personal claim against the corporation.

There are, nowadays, very few cases where the petitioner seeks not a general inspection of the books, but only a list of the stockholders. In one such case during the past year, a preliminary trial was ordered to determine the petitioner's good faith; in a second case, the inspection was denied because the application was not made in good faith. A third application resulted in a 3-2 decision of the Appellate Division, the majority refusing to let the applicant see a list of his fellow-stockholders, which he sought to enable him to ask them to join in a stockholder's suit he had instituted. The decision is so illogical that it cannot

34. Matter of Evans, 116 N.Y.L.J. 716 (Sup. Ct. Oct. 2, 1946, Sneed, J.) (J. H. Evans & Sons, Inc.). Cf. the cases cited in note 38 infra where inspection of the stock book alone was sought and denied on the ground of bad faith. Such decisions are difficult to reconcile with Schulman v. Louis Dejonge & Co., 270 App. Div. 147, 149, 59 N.Y.S.2d 119, 122 (1st Dept. 1945), wherein the Appellate Division ruled that the proper procedure when bad faith has been charged is to grant an alternative order directing a trial of this issue.
be fitted into a coherent analysis of stockholder's rights. The case is now pending in the Court of Appeals, where reversal seems probable.

During the past year there was also one case of "man bites dog"; a large corporation endeavored to enjoin a former officer from using a list of the stockholders he had already obtained. The court declared that if the defendant's conduct is wrongful "it can only be on the theory that it was improper and wrongful for a corporate officer to obtain a list of its stockholders for the purpose of accomplishing a change of management, irrespective of whether or not the change was sought in the best interests of the corporation itself." The court refused to enjoin the former officer. A touch of color is added by the circumstance that the old management was headed by Serge Rubenstein and it was the directors alleged to be under his influence who unsuccessfully tried to prevent the stockholders' list from being used to oust them.

It appears from the cases, therefore, that the right of a stockholder to inspect the books of his corporation and to learn the names of his fellow-stockholders is now the most enforceable of all the stockholder's rights.

III

A third feature, required by the shareholder to manage his corporation, is the power to hold the directors accountable for misconduct in office. Once again the surrender by stockholders-to-be of this right is sometimes arranged by promoters and their attorneys when the corporation's charter is drafted, usually in the form of a provision purporting to relieve directors from equitable restrictions while dealing with themselves.

Some courts, including New York, hold the directors accountable despite the "blank check" given them by the charter. Redress then is secured through stockholder's derivative suits, which rapidly increased in number after 1933, when Congressional disclosures made known to stockholders how some directors and officers were looting their corporations.

The corporate immunity which promoters tried unsuccessfully to secure by charter provision is now supplied by legislation in a number of states, including New York. This legislation purports to require "security for costs," but was intended to and, in operation, has resulted in killing off virtually all stockholder litigation affecting large corporations. I am inclined to believe that, whatever the legislators may have

42. Hornstein, The Death Knell of Stockholders' Derivative Suits in New York, 32
thought before rushing to enact Section 61-b of the General Corporation Law, they never suspected the dangerous precedent they were introducing by making a minimum of wealth prerequisite to invoking the protection of the courts. We can no longer laugh at Anatole France’s satirical comment: “The law forbids the rich man as well as the poor to sleep in the park.”

This new legislation has been strictly construed. Lewin v. New York Ambassador, Inc. et al. involved the New York statute, Section 61-b, and may be of special interest to practitioners. There it was held that since a voting trust certificate holder is not mentioned in Section 61-b, he is not subject to its requirements and need not put up security as a condition to maintaining a suit in equity. The court’s decision is sound, although the exception was not the result of legislative deliberation.

Inasmuch as the danger of secret settlements was the reason urged to justify the legislation, a question arises as to whether the legislation will be repealed now that secret settlements, as a practical matter, have been eliminated by Young v. Higbee Company in the United States Supreme Court and Clarke v. Greenberg in the New York Court of Appeals, decisions which hold that a stockholder who by a secret or “private” settlement receives more than the fair value of his stock is accountable to the corporation and his fellow-stockholders for the excess.

Although my records for 1946 show no less than 85 decisions involving some phase of the derivative suit, I shall call attention to only a very few of the year’s cases. Despite Section 61-b this learning is not purely academic; it is still relevant in the case of small corporations in the New York state courts, and in the case of both large and small corporations in the federal courts of New York.

The three basic questions are: who has capacity to sue, on behalf of whom, and for what?

The year’s decisions have again declared the right to sue, not only of a stockholder of record, but of an equitable owner, a policyholder in an insurance company, a judgment creditor, and a trustee in bank-
ruptcy. Capacity to sue is now complicated by the doctrine of contemporaneous ownership, which requires that a stockholder-complainant in a derivative suit must have been a stockholder at the time of the transactions complained of. Especial note should be made of the fact that although a stockholder is barred by this restrictive legislation, in my opinion a director is not; consequently in a small corporation, a stockholder who can have himself elected a director may thereafter sue as a director for wrongs before he became a stockholder, if the wrongs are within the statute of limitations. The suit is then not technically a stockholder's suit, but the redress in dollars will be even greater.

A number of decisions found it necessary to point out that, even in a two-man corporation, plaintiff's suit against his co-stockholder for an injury to the corporation must be through a derivative suit on behalf of the corporation. The term "derivative suit" immediately indicates that the basis of suit is "derived"; it is on behalf of another. On whose behalf may suit be maintained? It has long been established that suit may be maintained on behalf of complainant's own corporation, and even on behalf of a wholly owned subsidiary—a "double-derivative" suit. During the past year suit was permitted to be instituted on behalf of a wholly owned subsidiary of a wholly owned subsidiary. This "triple-derivative" suit occurred in a federal court in New York and the complaint was upheld, decisively. The Circuit Court of Appeals for the Second Circuit ruled that not only could such a triple-derivative suit be maintained, but that it was an abuse of discretion for the Trial Court to approve a proposed settlement. The Circuit Court said the settlement should have been disapproved "because on the facts presented the liability of the individual defendants was indubitable and the amount of recovery beyond doubt greater than that offered in settlement."

The basis of complaint—the gravamen of action—is always important. The grounds for complaint, sustained by decisions during 1946,
were those usually encountered in the past, but the surprising feature is the number of complaints seeking redress for directors' breach of corporate opportunity. An interesting variation occurred in *North v. Ringling,* which sustained the sufficiency of a complaint to hold directors accountable on a charge of gross negligence resulting in the disastrous fire which destroyed the Ringling Circus in Hartford, Connecticut. Nowadays one rarely finds this type of derivative suit—a complaint of negligence without a charge of fraud or illegal benefits to the defendants. The law, of course, is well established that directors are liable not only for failure to act in good faith but also for failure to exercise that diligence, care, and skill which men of ordinary prudence would exercise in their own affairs.

In drafting a complaint, one must always consider the Statute of Limitations. No experienced practitioner will draft a complaint in any field of law without trying to determine whether suit is barred by the Statute of Limitations. Especially is this so in derivative litigation where different periods of limitation apply to different types of misconduct. The most important decision in this field last year was rendered by the Court of Appeals. The suit there was not by a stockholder, but by the corporation itself; however, the statute would cause the same result were a stockholder suing derivatively. The defendants were charged with causing cancellation of a contract which the corporation had previously enjoyed and then establishing a rival business to take it over. The court held that the suit having been instituted before the amendment to the statute lowering the period of limitations, a 10-year period was to be allowed, upon the theory of making the defendants accountable for a resulting trust; this theory, incidentally, would make the measure of damages the profit gained by the defendants, and not merely the loss to the corporation.

54. The bases of action generally advanced in the complaints may be gleaned from recent cases listed in Frey, *Private Corporations,* 94 U. of Pa. L. Rev. 265 (1946).
Under the present New York laws, a shorter statutory period protects directors, officers, and stockholders, and this shortened period starts running—even in the case of a concealed fraud—from the date of its commission, not from the date of discovery or discoverability of the fraud. Note, however, that again the legislature, although attempting to cut down the period of limitations, was careless; even under the new limitations the period is still 10 years for fraud in a suit against a party who is neither director, officer, nor stockholder, and therefore not in the privileged class set up by the amendments to Sections 48 and 49 of the Civil Practice Act. Logically, one would not expect the period of time within which suit may be brought to be less for those in a fiduciary relationship than for non-fiduciaries.

Once the complaint has been drafted, a new problem arises: The complainant, in the case of a small corporation, usually fears that his interest in the corporation will be imperilled unless a receiver is appointed pendente lite. The cases last year were evenly divided: two granting and two refusing the appointment of a receiver. In a fifth case, which seemed to be a strong one for the appointment of a receiver, a receivership ordered by Special Term was vacated by the Appellate Division—without opinion. The subject is one on which the profession is waiting to see the applicable law stated.

The 1946 decisions on examination before trial appear to be routine. The only one of special interest was a case where the court ruled that

59. The period is now six years if the action is for an accounting, six years if based on fraud, and three years if the action is "for waste or for an injury to property or for an accounting in connection therewith" N.Y.C.P.A. § 48, subd. 8. (Italics by the author).

60. The term "fraud" is employed in the text in its usual sense in stockholders' derivative suits where breach of duty by directors is characterized as conduct "in fraud" of the corporation and its stockholders. In rare instances where there is actual fraud, satisfying all the prerequisites of a common law action for fraud and deceit, the New York courts will probably rule that a six year period of limitations applies and starts running only from the time of discovery of the facts constituting the fraud. See Ziring v. Corrugated Container Corp., 49 N.Y.S.2d 686, 690 (Sup. Ct. 1944, Hooley, J.); Gottfried v. Gottfried, 269 App. Div. 413, 417, 55 N.Y.S.2d 50, 55 (1st Dept. 1945); Myer v. Myer, 271 App. Div. 465, 475-6, 66 N.Y.S.2d 83, 93 (1st Dept. 1946); Am. Cities Power & Light Corp. v. Williams, 117 N.Y.L.J. 1111 (Sup. Ct. March 21, 1947, Shientag, J.). The foregoing judicial comments (since the 1942 amendment) on the distinction between "constructive" and "actual" fraud have been dicta only, the court in each case ruling that "actual" fraud was not sufficiently alleged.


defendants had violated an order for inspection when they gave the books one at a time—an old defense technique, usually tried on an inexperienced adversary.65

Another defense strategy is the motion for summary judgment. A case in which it succeeded during the past year illustrates the type of case in which it should be made. This was Koff v. Hochschild, 66 where summary judgment was granted on the basis of res judicata, to wit, an intervening decision in another stockholder’s suit involving the same cause of action. There were in other cases defendants’ motions for summary judgment which proved unsuccessful because not so soundly based. 67

This first major grouping of the stockholder’s “bundle of rights”—his right to manage the corporation—has all but disappeared. The promoters have sometimes completely eliminated his right to vote, as they have also tried to deny him the right to inspect or to hold the directors accountable for misconduct. In the latter two situations, the courts reached out to protect the stockholder, and the legislatures, in turn, by nullifying somewhat the efforts of the courts, have thereby, in effect, taken these “rights” out of the bundle—for, it is idle to talk of “rights” unless they are enforceable in court.

The Stockholder’s Right to Receive Money from the Corporation

The second major grouping of the stockholder’s rights concerns his power to secure money from the corporation, either in the form of declared dividends or of a liquidating dividend on dissolution of the corporation.

In legal theory the directors alone determine when and if dividends are to be declared. But here, as elsewhere, the court can give relief. Although the cases are few in which a court has compelled directors to declare dividends, courts have done so in New York as well as in other states.68

During the past year, in only a single case was the sufficiency of a complaint to compel declaration of dividends sustained and in that case, the claim was that dividends were mandatory under the charter, not discretionary.69

The dissolution of a corporation at the suit of a minority stockholder is just as unusual in this country as a judicial declaration of dividends. But the courts do acknowledge the power to order dissolution as incidental relief when those in control have been guilty of misconduct. An illustrative case occurred during the past year, where the plaintiff complained of excessive salaries and other misconduct. The Appellate Division reversed the trial court's dismissal of the complaint and, in sending the case back for re-trial, impliedly approved the form of relief sought—dissolution of the corporation.

The rarity of dissolution as a form of judicial relief for misconduct makes almost entirely theoretical the so-called “right” of the stockholder to share in the residual assets of the corporation should it ever be formally dissolved or liquidated. Large corporations are almost never liquidated; they are “merged” or reorganized. What the stockholder then receives is determined by the binding effect, if any, of his so-called “contract” with the corporation, the next subject to be considered.

THE STOCKHOLDER’S RIGHTS TO MAINTAIN THE ORIGINAL CORPORATE CONTRACT

The third major grouping of the stockholder's rights concerns his power to prevent changes in the original contract between the corporation and its shareholders. When we studied contracts at law school, we thought, with the naiveté of a Gertrude Stein, that a contract was a contract—equally binding on both sides. This faith is not justified in the case of the corporate charter contract. Originally, the charter contract was considered as inviolable as other contracts and consequently could not be changed if a single stockholder objected, even if the change was beneficial to the corporation and the stockholders as a group. This veto power was subject to abuse by individual stockholders who sometimes demanded and received more than was fair for consenting to a change. Laws were thereupon enacted permitting changes in


72. Impairment of the obligation of contracts is evaded, constitutionally, by the reservation of the power to amend corporate charters which is contained in the enabling general corporation law of almost every state, a reservation inspired by the decision in Trustees of Dartmouth College v. Woodward, 4 Wheat. 518 (U.S. 1819). The stockholders, consequently, are deemed to consent in advance to any modifications of the corporate charter provisions to be made in the future not only under authority of statutes in force at the time of incorporation but also under authority to be given by future amendments of the state corporation laws—which in many states are custom-made to suit the desire of corporate managements.
the contract if approved by a specified percentage of those concerned, and giving the right to objectors to demand and receive payment for their aliquot share in the corporation. To meet the competition of states like Delaware, New York has gone far in permitting changes of every conceivable nature. During the past year the New York Court of Appeals, in *Anderson v. International Minerals*, 73 upheld the constitutionality of such legislative authorization. This practice would not be subject to criticism if the objectors who are forced out of the going enterprise were adequately safeguarded in their appraisal rights, but they are not. In a recent instance, 69 holders of preferred stock in a Delaware corporation learned after six years of litigation that the alternative to consenting to what they deemed an inequitable reclassification of preferred stock in a solvent corporation was that they could be forced by a Delaware court of equity to surrender their stock for less than par although holders of common stock in the old corporation had received recognition. 74

There are several hard-hitting law review comments on legislation and judicial decisions which permit such a state of affairs. 75 Certainly, this final group of “rights” has been so weakened that the stockholder must rely, as Professors Berle and Means said 15 years ago, “not on legal rights,” but “on a set of expectations that the men who compose the management and control will deal fairly with his interest.” 76

It is possible some may feel that this cumulative discussion of the rapidly vanishing rights of the stockholder is unfair because not all the “rights” are obliterated in a single corporation. Unfortunately, however, there are corporations where practically every element in the “bundle of rights” is negatived. The Pennroad Corporation, in which some 150,000 investors made a capital contribution at the time of incorporation, may serve as an example. It was incorporated in Delaware in 1929. The stock of the newly-formed corporation was simultaneously placed in a voting trust, so that purchasers who furnished the capital received in return only voting trust certificates, which effectually barred them for at least 10 years from any voting control over the management. Although the highest court in Delaware had several years earlier ruled that the “no inspection” provision in a charter is void, the Pennroad charter contained not only the conventional prohibition against inspection of the books by stockholders, but also a further provision that the corporation should not be required to make known to stock-

76. *Berle and Means, Modern Corporation and Private Property*, 188 (1932).
holders any statement concerning its assets or liabilities. The usual exculpatory clause for directors was present too. Delaware's so-called liberality in permitting alterations in the contract rights of shareholders, despite their objections, has been notorious for many years, and no case has come to my attention in which a Delaware court ever ordered a declaration of dividends or dissolved a corporation at the suit of a minority stockholder. It is not surprising, then, that the stock market appraisal of the value of Pennroad voting trust certificates at one time dropped to almost nothing. Even speculators are reluctant to bid for an engraved certificate showing that someone made a capital contribution but received in return for it few or no enforceable rights.

Fortunately, the courts in most states have always found legal tools to effectuate justice. But the courts cannot act unless a matter is before them. That is why the right of the stockholder to resort to the courts should be maintained. The Pennroad Corporation is again an object lesson. As a result of the disclosures by the Wheeler investigation in 1938, suits were instituted by a number of stockholders who previously had had no inkling of what had transpired. The small number of shares owned by the complainants was the subject of ridicule by The Pennroad Corporation in its annual report to stockholders, but the result of the suit was not a laughing matter. A judgment of over $23,000,000 was awarded after trial. This award, however, was reversed by the Circuit Court of Appeals, which held that the Delaware state statute of limitations should have been applied and the suit therefore barred.1 Thereafter, the suit was settled for a cash payment to the Pennroad Corporation of $15,000,000, a tidy sum which added approximately 30% to the assets of this corporation.2

The Pennroad Corporation, organized under the most reputable auspices, has been used simply to demonstrate first, what ultimately develops when the stockholder gives up most of his "bundle of rights," and secondly, the importance and cash value to a corporation of the rights of its stockholders to appeal to the courts.

**CONCLUSION**

The business corporation is a vital element in our economic structure. For half a century, however, public attention was directed to corporate relations with the public (the consumer) and with labor. Ripley's eye-opening series of *Atlantic Monthly* articles in 1926-1927,3 shortly followed by Berle and Means' thoroughly documented analysis,4 spot-

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79. Reprinted in Ripley, Main Street and Wall Street (1927).
80. Berle and Means, Modern Corporation and Private Property (1932).
lighted intracorporate problems. Management's relations with the stockholders, it is now appreciated, are also a subject of public concern, not only to do justice in specific cases, but to assure that investors are not discouraged from making future capital contributions.

Despite the considerable advance in investor protection effected by the federal securities legislation since 1933, much can still be done. A possible solution is to prescribe that where a charter is offered for filing—if the assets, whether raised by stock or bond issues, exceed $5,000,000—there must be review and approval by an official with more than purely ministerial powers. Standards could be specified requiring rejection of the papers where the charter includes provisions already declared invalid or unenforceable by a court of competent jurisdiction, or where the corporate structure lends itself to unfair or inequitable distribution of voting power among the security holders. Suggestive standards will be found in the Investment Company Act of 1940.

Conserving the stockholder's right to vote, of course, will not alone eliminate the possibility of intracorporate abuse. Even where the right to vote is vested in the stockholders, the management frequently relies on the nature of the proxy system to protect itself from ouster, however flagrant its misconduct. Proxy practices still current in corporations not subject to SEC surveillance were graphically disclosed in a 1946 SEC report to Congress.

Legislative efforts to protect stockholders would, however, prove to be a boomerang if interpreted as a substitute for the stockholder’s right to invoke the aid of the courts. It is encouraging, therefore, to observe in a recent decision of the Supreme Court of the United States that, despite a 5-4 division on the immediate issue of the applicability of the doctrine of forum non conveniens, all nine justices agreed on the right of a policyholder, as well as a stockholder, to maintain a derivative suit on behalf of the company. Should the right to resort to the courts be taken away—directly or indirectly—nothing will be left of the stockholder’s so-called rights.

81. Hornstein, Legal Controls for Intracorporate Abuse—Present and Future, 41 Col. L. Rev. 405 (1941).
82. A registered investment company may not issue non-voting stock, §18(i); may not issue more than two classes of stock, one class of preferred and one of common, §18(c); may not issue stock for property or services, but only for cash or securities, §23(a); may not issue warrants good for more than 120 days, §18(d); may not issue voting trust certificates, §20(b); may not have cross-ownership or circular ownership which would make it impossible to dislodge the management, §20(c); may not purchase its own stock except in a manner insuring fair treatment to all security holders, §23(c). All the foregoing section references are to the Investment Company Act of 1940, 54 Stat. 789 et seq., 15 U.S.C. §80a-1 et seq. (1940).