Corporations-Preferred Stockholder's Suit to Compel Declaration of Dividends

Follow this and additional works at: http://www.repository.law.indiana.edu/ilj

Part of the Securities Law Commons

Recommended Citation
Available at: http://www.repository.law.indiana.edu/ilj/vol15/iss6/7
importance of this distinction in view of the fact that, in either case, the mortgagor's possession is rightful.

The closer question arises where there is a mere retention of possession of the mortgaged property with permission for its use by the mortgagor, without additional facts from which consent can be implied.\(^\text{18}\) Some cases have held the deciding factor to be whether or not the repairs were reasonably necessary for the continued use of the mortgaged property.\(^\text{19}\) But these facts alone, even where the nature of the property is such that its use will obviously necessitate repairs, should not be held to support a finding of implied consent, for such would lead, in any event, to the unreasonable result of allowing the mortgage security to be impaired by a use in which the mortgagee has no interest.

The lack of harmony in the cases involving this question makes apparent that there are strong reasons in policy favoring either side.\(^\text{20}\) But it would seem that cases giving priority to the subsequent mechanic's lien on such inadequate grounds have ignored the purpose of the recording statutes. Because of the helpless position of the mortgagee with respect to mortgaged property retained in the possession of the mortgagor, as is the usual custom, and of the facilities afforded by the record whereby the repairman can protect himself, it appears reasonable to place the burden on the repairman to discover if property delivered to him is encumbered. If such should be the case, he may proceed on the personal credit of the mortgagor, or secure the mortgagee's express consent that the mortgage lien be subordinated. A bona fide purchaser from the mortgagor would be unprotected\(^\text{21}\) and it is questionable whether a repairman should receive more protection.

In view of the extensive use of chattel mortgages at the present time in financing purchases of automobiles it appears important to protect the security of the mortgage transaction as much as possible. It is submitted that, in the light of the recording statute, the principal case is a justifiable limitation on the doctrine of implied consent as an exception to the general rule that a lien prior in time is prior in right.

C. D. S.

\footnotesize

\begin{itemize}
  \item \textit{Corporations—Preferred Stockholder's Suit to Compel Declaration of Dividends.}—Stockholder brought an action to recover dividends accrued on cumulative preferred stock. The corporation was completely dominated by its president, who alone opposed this suit. The other two directors were not made defendants. The court rendered judgment for the amount of the delinquent dividends and decreed a contingent payment of dividends so long as the corporation is possessed of surplus or earnings in profits from which to pay

\begin{footnotes}
  \item \textsuperscript{20} Further evidence of the conflict in policy is shown by the variety of treatment which the problem has received in state statutes on the subject. See I Jones, \textit{Lien} (3rd ed. 1914), secs. 749 to 786c.
  \item \textsuperscript{21} Liver v. Mills (1909), 155 Cal. 439, 101 Pac. 299.
\end{footnotes}
dividends without impairment of its capital. Held, modified and affirmed. A court of equity may order dividends paid out of earnings on preferred stock when the officials of the corporation have acted in bad faith. It was error for the lower court to order payment of dividends in the future. *O'Neill v. O'Neill* (1940, Ind. App.), 25 N. E. (2d) 656.

The right of the preferred stockholder to dividends is generally interpreted not as a common stockholder's right to share in profits but as a right arising out of, and enforceable on, the theory of contract.1 The Indiana courts may not be in accord with this interpretation, as they have consistently declared that the preferred stockholder "is entitled to all the rights of the common stockholder, except as modified by statute and contract." However, this contractual right of the preferred stockholder confers on him no legal right to a division of profits until a dividend has been made or declared.2 He is not a creditor of the corporation but a stockholder.4 This is true even though the dividends are said to be "guaranteed" by the corporation.5 The preferred stockholder is not left without any protection, as his rights are enforceable in equity in accordance with the terms of the contract securing the preference.6

In addition to the contractual limitations imposed upon the preferred stockholder's right to dividends, the courts adhere strictly to the general rule that dividends can only be declared out of profits. Taft v. Hartford, etc., R. R. (1886), 8 R. I. 310; Field v. Lamson & Goodnow Mfg. Co. (1894), 162 Mass. 388, 38 N. E. 1126, 27 L. R. A. 136. The guaranty may have the effect of making the right to dividends cumulative. Austin v. Wright (1930), 286 Wash. 26, 156 A. L. R. 568; Boardman v. Lake Shore Ry. (1881), 84 N. Y. 169, 15 N. Y. 157.

In Allied Magnet Wire Corp. v. Tuttle (1926), 199 Ind. 166, 154 N. E. 480, 50 A. L. R. 252 (rehearing denied, 199 Ind. 177, 156 N. E. 558), the contract provided on failure to pay any dividend for ninety days that the preferred stock would mature and be redeemed at the option of the holder. The court refused appointment of a receiver and interpreted the contract to mean that dividends were payable only if proper funds were available.

---

1 Spear v. Rockland-Rockport Lime Co. (1915), 113 Me. 285, 93 Atl. 754, 6 A. L. R. 793; Fletcher, *Cyclopedia Corporations* (1932), sec. 5443. The contract may be evidenced by statute, article, by-law, or, most usually, by the stock certificate. On the general subject of this note see: 6 A. L. R. 793; 67 A. L. R. 780; 98 A. L. R. 1526.

2 Star Publishing Co. v. Ball (1922), 192 Ind. 158, 134 N. E. 285; Cring v. Sheller Wood Rim Mfg. Co. (1933), 98 Ind. App. 310, 183 N. E. 674; Grover v. Cavanaugh (1907), 40 Ind. App. 340, 82 N. E. 104. This is particularly important in determining whether the preferred stock is participating. If the preferred stock has all the rights of the common and in addition the right of preference, it would follow that the preferred stock is participating unless otherwise provided. This is a minority view held chiefly by the Pennsylvania courts. Fidelity Trust Co. v. Lehigh Valley R. R. Co. (1906), 215 Pa. 610, 64 Atl. 829. See (1925-26), 11 Cornell L. Q. 230. No Indiana cases have been found on this question.

3 Fricke v. Angemeier (1912), 53 Ind. App. 140, 101 N. E. 329. After the dividend has been declared, the corporation becomes indebted to each shareholder for his share and the stockholder may recover it in an action at law against the corporation. Lee v. Fisk (1915), 222 Mass. 418, 109 N. E. 833; Fletcher, *Cyclopedia Corporations* (1932), sec. 5451.


5 The guaranty is interpreted by the courts to be limited by the rule that dividends can only be declared out of profits. Taft v. Hartford, etc., R. R. (1886), 8 R. I. 310; Field v. Lamson & Goodnow Mfg. Co. (1894), 162 Mass. 388, 38 N. E. 1126, 27 L. R. A. 136. The guaranty may have the effect of making the right to dividends cumulative. Austin v. Wright (1930), 156 Wash. 24, 286 Pac. 48; Boardman v. Lake Shore Ry. (1881), 84 N. Y. 157.

dividends are payable only out of surplus profits or net earnings; or stated conversely, that dividends may not be declared out of capital.\(^7\) The courts use these terms interchangeably and are disinclined to analyze financial structures carefully. This limitation is used very effectively against the stockholder in his suit to compel declaration of a dividend, as the burden is upon him to establish proper funds.\(^8\)

But once having established his right according to these first two considerations, the preferred stockholder in his action to compel a declaration of dividends is ultimately met with the general rule that the directors of a corporation are the sole judges as to the propriety of declaring dividends and the courts will not interfere with the proper exercise of that discretion.\(^9\) Such a principle is sufficiently elastic to comprehend every situation. But the question, obscured by this generality, is whether a different construction of the rule applies to different classes of stock. No case has been found which distinguished between two classes of stock in the same action. The majority of the courts declare the general rule to be applicable to both preferred and common stock and then apply the rule to the particular facts without distinguishing a different standard of conduct for different classes of stock.\(^10\) It would seem that the preferred stockholder is entitled to a greater protection than the common stockholder. Otherwise the corporation might indefinitely postpone payment of dividends in an honest policy of expansion which would work for the benefit of the common stockholder at the risk of the preferred stockholder. This result is possible where the courts hold the contract of preference to mean only that the corporation must pay dividends to the preferred stock before any dividends can be paid to the common stock.\(^11\)

The problem is raised more acutely in the case of non-cumulative preferred stock. The United States Supreme Court has held that if dividends on non-

---

\(^7\) Fletcher, Cyclopaedia Corporations (1932), sec. 544; Cring v. Sheller (1933), 98 Ind. App. 310, 183 N. E. 674. This is true even in absence of contract. Allied Magnet Wire Corp. v. Tuttle (1926), 199 Ind. 166, 154 N. E. 480, 50 A. L. R. 252.


\(^12\) Spear v. Rockland-Rockport Lime Co. (1915), 113 Me. 285, 93 Atl. 754, 6 A. L. R. 793.
cumulative preferred stock are passed in the proper discretion of the board of directors, though there are proper funds available, the claim for that year cannot subsequently be asserted. Thus directors may accumulate a fund at the expense of the non-cumulative preferred stockholders which may be distributed in a subsequent year to the common stockholders after payment of only a single year's dividend to the preferred.

Proper exercise of discretion is a phrase of convenient elasticity. Courts have found an abuse of discretion to mean fraud, bad faith, oppression, or merely arbitrary or unjustifiable conduct. It is not contended that the courts should compel a declaration of dividends as a matter of right where there are proper funds available. The internal management of a corporation is not within the province of the courts. A few corporations have contracted away the discretion of the board of directors and made dividends a matter of right if proper funds are available, but such contracts are subject to the court's refusal to so interpret them. Since the board of directors is in most instances controlled by the common stockholders, it is submitted that the courts should show a greater willingness to interfere in this type of suit and examine closely the exercise of discretion by the board of directors in order to insure a more adequate protection of the preferred stockholder's right to dividends.

The principal case seems entirely sound. The complete domination of the board of directors by the president, the absence of directors' meetings except for organization purposes, and the president's attempt to purchase the plaintiff's stock with the corporate assets seem quite sufficient to support a finding that the board of directors acted in bad faith and oppressively. The failure to join directors as defendants in this type of suit occasionally has been held objection-

13 Wabash Ry. v. Barclay (1930), 280 U. S. 197, following N. Y. etc. Ry. v. Nivkals (1886), 119 U. S. 296. The holding of the Wabash Ry. case definitely rejects any theory of safeguarding non-cumulative stockholders by implying a credit each year from profits available which may be required to be paid at any time in the future. See Berle, Non-Cumulative Preferred Stock (1923), 23 Col. L. R. 358. The Wabash Ry. case holds merely that no claim can be made for dividends once passed and does not prohibit the board of directors from declaring dividends for the lapsed periods if they so desire. This situation is unlikely, as common stockholders usually control the corporation. Collins v. Portland Electric Power Co. (1925), 7 F. (2d) 221, affd. 12 F. (2d) 671, 48 A. L. R. 73.

14 The protection accorded to non-cumulative preferred stockholders by building up a fund for future distribution by implying a credit each year from earnings if dividends are not declared has been criticized as being too liberal on the ground that sufficient protection can be given on broad principles of equity. This is true if the courts take the position of the Indiana Supreme Court in Star Publishing Co. v. Ball (1922), 192 Ind. 158, 134 N. E. 285, stating that the court would scan closely a refusal to declare dividends where there are net profits and where the preferred stock is non-cumulative.


able, but the court in the principal case appears correct in rejecting such objection on the ground that the corporation was adequately protected. The court's ruling in the principal case against that part of the decree ordering payment of dividends in the future in event of profits seems correct. A court of equity should not compel a declaration of dividends until after the board of directors has exercised its discretion and an abuse of such discretion has been shown.

W. S. H.

CONSTITUTIONAL LAW—APPEALS FROM ADMINISTRATIVE TRIBUNALS.—Plaintiff, an Indiana corporation organized to engage in the small loan business, sought to avoid the provisions of an Act of 1933 reducing interest rates and placing the small loan business under the control of the Department of Financial Institutions. The complaint in part charged that the act was invalid because it made no provision for an appeal to a court for a judicial determination of the questions involved. Held the validity of an act subjecting businesses of a certain character to rules and regulations of a non-judicial body does not depend upon provisions granting or failing to grant an appeal to the courts. Financial Aid Corporation v. Wallace (Ind. 1939), 23 N. E. (2d) 472.

Generically speaking, due process is not necessarily judicial process, nor is the right of appeal essential to due process of law. The right of appeal is not an inherent or inalienable right, except where expressly guaranteed by the State Constitution.

The general rule is that appeals are recognized as allowable only from judicial decisions, and administrative tribunals or departments do not ordinarily render judicial decisions. A fundamental principle underlying the right of appeal in all cases is, that in the absence of express statutory provision to the contrary, the decision appealed from must have been made by a tribunal or officer vested with judicial authority, and while acting in a judicial capacity. It has repeatedly been held that an appeal will not be allowed to the courts from the purely ministerial or administrative action of a public officer, board, commission, or similar tribunal, without express statutory authority. The court held in the principal case that the act conferred administrative, and not judicial, authority.

19 Stevens v. U. S. Steel Corp. (1905), 68 N. E. Eq. 373, 59 Atl. 905.
3 In re Petition to Transfer Appeals (1931), 202 Ind. 365, 174 N. E. 812.
4 Ferrell v. State (1898), 151 Ind. 247, 51 N. E. 360.
5 U. S. v. Ferreira (1851), 13 How. 40, 14 L. Ed. 42; Indianapolis v. Hawkins (1913), 180 Ind. 382, 103 N. E. 10; Board v. Davis (1894), 136 Ind. 503, 22 L. R. A. 515.
7 "An administrative officer charged with the administration of the laws enacted by the General Assembly necessarily exercises a discretion partaking of the characteristics of the judicial department of the government, but does not have the force and effect of a judgment." Financial Aid Corporation v. Wallace (Ind. 1939), 23 N. E. (2d) 472, 475.