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DEVELOPMENTS IN BUSINESS CORPORATIONS—1950–1960

DAVID LEVINSON AND LOUIS P. HALLER

The first statute dealing with corporations enacted in Illinois was “An Act Concerning Corporations.” This act remained in force until 1919 when “The General Corporation Act” was enacted. In turn, this act was repealed by “The Business Corporation Act.” During the past ten years, prior to 1957 there were very few amendments to the Illinois Business Corporation Act.

1 Ill. Laws 1871–72, at 2964.
2 Ill. Laws 1919, at 312.
3 Ill. Laws 1933, at 308.
4 In discussing the development of corporate law in Illinois during the past ten years, the authors have confined themselves to the law relating to business corporations. There will be no reference made to amendments to the Illinois Business Corporation Act which merely change wording, rearrange sections, or are purely formal. In discussing the adjudicated cases, the authors have selected those which seem to them to be of some importance.

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Mr. Haller, a member of the Illinois Bar, received his A.B. and J.D. from the University of Michigan. He is a former chairman of both the American Bar Association Committee on Non-Profit Corporations and of the Chicago Bar Association Committee on Corporate Law. Mr. Haller, who authored “The General Not For Profit Corporation Act, Historical Commentary” (Ill. Ann. Stat. ch. 32, §§ 158 to end, at xvii (Smith-Hurd 1954)), and co-authored the Illinois Business Corporation Act Annotated, is also a partner in the above-mentioned firm.
1951 AMENDMENTS

In 1951, the jurisdiction of a court of equity to liquidate assets and business of a corporation was broadened by inserting a provision in the act, section 86 (a) (2),6 giving power to liquidate when the shareholders are deadlocked in voting power and have failed for a period, which includes at least two consecutive annual meeting dates, to elect successors to directors whose terms have expired or would have expired upon the election of their successors. Theretofore, the corporation could be liquidated in an action by a shareholder only (1) when the directors were deadlocked and irreparable injury to the corporation was being suffered or threatened by reason thereof, or (2) when the acts of those in control were illegal, oppressive, or fraudulent, or (3) when the corporation’s assets were being misapplied or wasted.

Section 86 has been construed by the Supreme Court in Central Standard Life Ins. Co. v. Davis,7 and in Gidwitz v. Lanzit Corrugated Box Co.8 In the former case, holders of preferred stock of the corporation, Abraham Lincoln Hotel Company, filed representative action asking the court to direct the sale of the assets and the liquidation of the corporation. The acts of the controlling stockholder, Davis, were alleged to be illegal, oppressive, or fraudulent. The hotel company had entered into a lease with a hotel operating company, also controlled by Davis. The court held that the plaintiffs had not brought themselves within one of the sub-sections of section 86, which gave power to a court of equity to liquidate a corporation under certain circumstances; that there was no evidence of misuse of funds, and that the fact that the income from the operations was not sufficient to show a profit could not in and of itself justify a finding of oppression. The opinion discussed at great length the basis for dissolution and liquidation as authorized by the statute, and held that there was no evidence of oppression. On review by the Supreme Court, the Appellate Court’s decision9 was affirmed, with the statement:

The concept of oppressive conduct as a ground for dissolution of a corporation in equity appears for the first time in the 1933 act. The able briefs of counsel have not referred us to any authoritative determination of its precise scope.

7 10 Ill.2d 566, 141 N.E.2d 45 (1957).
8 20 Ill.2d 208, 170 N.E.2d 131 (1960).
Plaintiff argues that the word "oppressive" does not necessarily savor of fraud, and that the absence of "mismanagement, or misapplication of assets" does not prevent a finding that the conduct of the defendants has been oppressive. We agree with that interpretation, and we reject defendants' argument that the word is substantially synonymous with "illegal" and "fraudulent." Misapplication of assets or mismanagement of funds are not, as we read the statute, indispensable ingredients of "oppressive" conduct.\(^\text{10}\)

In the *Gidwitz* case, shareholders of fifty per cent of the defendant corporation were successful in procuring a decree of dissolution based upon proof of what the Supreme Court held to be "oppressive" conduct. The plaintiffs had been deprived of participation in the management of the corporation, although two of them were directors. The president, without consulting plaintiffs, and without board authorization, organized with funds of the corporation a subsidiary which lost some $290,000 during a five-year period. There had been a ten-year deadlock which defendants refused to break by increasing the number of directors from four to five. The president had hired a person at a salary of $32,500 and the promise of a car to be managing officer of the corporation, but to serve (without title) in the capacity of executive vice president. The president made arbitrary reductions from the salary of one of the plaintiffs, who was an officer of the corporation. Without board approval the president borrowed moneys for the corporation from a bank; and on two occasions borrowed moneys from a corporation of which he was president and from a partnership composed of the president and his two brothers. Without board authorization the president executed a proxy to himself to vote the stock of a subsidiary corporation. The president failed for ten years to consult with directors, other than his brother, on corporate policies.

In discussing the meaning of the word "oppressive" the court said:

> We have held that the word "oppressive" as used in this statute, does not carry an essential inference of imminent disaster; it can contemplate a continuing course of conduct. The word does not necessarily savor of fraud, and the absence of "mismanagement, or misapplication of assets," does not prevent a finding that the conduct of the dominant directors or officers has been oppressive. It is not synonymous with "illegal" and "fraudulent." . . . [Citation omitted.]

\(^{10}\) Central Standard Life Ins. Co. v. Davis, 10 Ill.2d 566, 572-74, 141 N.E.2d 45, 49 (1957). It is strange that in neither the Appellate nor the Supreme Court opinion was the theory of Shlensky v. South Parkway Bldg. Corp., 19 Ill.2d 268, 166 N.E.2d 793 (1960), reversing, 21 Ill. App.2d 538, 159 N.E.2d 31 (1959), discussed in the text, although the transaction complained of in the *Shlensky* case was the leasing of property to a corporation controlled by the dominant stockholder, which was the situation in the *Lincoln Hotel* case.

It is clear that Joseph Gidwitz has used his position as president of a closely held corporation, split fifty-fifty in stock ownership between his family and the family of plaintiffs, to completely control and manage the corporation without majority stock support. The plaintiffs, as stockholders, have been effectively deprived of their rights and privileges. The record indicates a continuing course of conduct on the part of Joseph Gidwitz and the defendants to seize and hold the corporate entity to the complete exclusion of plaintiffs from their lawful right to participate in the management of Lanzit. Moreover, plaintiffs have even been deprived of their effective power as directors and officers of Lanzit.

The rights to which plaintiffs as officers, directors and shareholders of Lanzit are entitled have been abused and denied. It is not necessary that fraud, illegality or even loss be shown to exhibit oppression of plaintiffs and their interest in the corporation.\(^\text{1}\)

The court further said that it was unnecessary to discuss the applicability of subparagraphs one and two. It would seem that subparagraph one was probably not applicable because of the inability to prove irreparable injury; however, subparagraph two would seem to have provided an almost mechanistic result. Just why the court relied on paragraph three and one word thereof—"oppressive"—instead of subparagraph two, does not appear from the opinion.

Section 5(c) provides that each corporation shall have power to have a corporate seal. In 1951, chapter 30, section 153b of the ILLINOIS REVISED STATUTES was adopted, abolishing the use of private seals on written contracts, deeds, mortgages, or other written instruments or documents theretofore required by law to be sealed, provided, however, that the attachment of a seal to any such document shall not affect its validity or character. In an unpublished opinion dated July 31, 1951, the Attorney General advised the Auditor of Public Accounts that the statute did not in his opinion have any force or effect with regard to the seal of a savings and loan association, saying "the distinction between a private seal and a corporate seal is, of course, well established." The authors find it difficult to agree with the quoted statement.

1953 AMENDMENT

In 1953, the Legislature adopted an act permitting foreign trust companies to act in a fiduciary capacity (but not have an office in Illinois) without complying with other laws of Illinois when there are reciprocal privileges in the state of incorporation of the trust company.\(^\text{13}\) To conform to this legislation, section 102 of the Business

\(^{12}\) Id. at 220, 170 N.E.2d at 138.

\(^{13}\) ILL. REV. STAT. ch. 32, §§ 304.1–5 (1959).
Corporation Act, relating to the admission of foreign corporations, was amended to provide that no foreign corporation shall be entitled to procure a certificate of authority under the act to act as trustee, executor, administrator, guardian, conservator, or in any other like fiduciary capacity. This means, in substance, that a foreign trust company may not be licensed to do business in Illinois under the Business Corporation Act, but may, without being licensed, act in Illinois in a fiduciary capacity where there is reciprocity.

1955 Amendment

In 1955, section 5(g), setting forth the general powers of corporations, was amended to exclude from the right to acquire securities of other corporations the right to own or control fifteen per cent or more of the voting shares of each of two or more banks or of a bank holding company except as permitted by an act relating to bank holding companies, and except that any such corporations may continue to own or control those voting shares which it owns or controls on the effective date of the amendment. This amendment was held to be constitutional, as was the bank holding company act itself, in *Braeburn Sec. Corp. v. Smith.*

1957 Amendments

In 1957, a number of amendments to the Illinois Business Corporation Act were adopted, many of which were intended to bring the act into closer conformity with the Model Business Corporation Act of the American Bar Association. Section 2(f) (without substantially changing the law as theretofore existing) was amended to adopt the Model Act definition of shares, as was section 2(j) with reference to the definition of treasury shares. To the latter section, however, there was added to the Illinois Act the following language not found in the Model Act: "Shares converted into or exchanged for other shares of the corporation shall not be deemed to be treasury shares." Section 2(o) added the Model Act definition of insolvency as meaning inability to pay debts as they become due in the usual course of business. Section 5(o) added to the general powers of a corporation the power "to establish pension plans, profit-sharing plans, share bonus plans, share option

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15 Ill.2d 55, 153 N.E.2d 806 (1958), *petition for leave to appeal denied, 15 Ill. App.2d viii (1958).*
16 American Law Institute, Handbook A.
plans, and other incentive plans for its directors, officers, and employees and to make the payments and issue the shares provided for therein.” This is substantially the language of the Model Act and was intended to eliminate any question of corporate power in these respects.

In Elward v. Peabody Coal Co., a suit filed before the adoption of section 5(o), plaintiff asked for a declaratory judgment finding a stock option invalid. On appeal from an order dismissing the complaint, it appeared that stock options were granted to two employees of the corporation, the charter having been amended to provide that shares might be issued from time to time without first being offered to any class of shareholders. The resolution granting the stock option was adopted at a meeting by five (two of whom were the individuals who had been granted stock options) out of seven of the directors. One of these directors cancelled his option. At an annual meeting of the shareholders, 66.15% of the outstanding shares were voted in favor of the option. In discussing the validity of the option, the court held that the preemptive right of shareholders to share pro rata in any new issue of stock is part of the common law of Illinois, and that this right may be denied or limited by charter amendment or in the case of shares sold to an employee, upon approval of the holders of two-thirds of the shares. It was contended that at the date of granting the option, section 5 gave no express power to grant stock options, but the court held that there was ample implied power in the provisions of section 5 to empower corporations to enter into contracts of employment and that under the provisions of section 24 shareholders’ preemptive rights had been limited. However, a director of a corporation is disqualified from voting on a resolution giving him an option to buy stock, and in this case, the directors’ resolution was not adopted by a qualified majority of directors. Regardless of the approval of the option by the shareholders, the option was held to be invalid because it granted the right to buy common shares of the par value of five dollars each at three dollars per share in contravention of section 17. The fact that stockholders of but 66.15% of the outstanding shares approved the options was not mentioned!

Section 4 of the act, relating to unified local transportation corporations, was repealed as no longer necessary, and language in section 3, relating to the organization of corporations for this purpose, was eliminated.

Section 6, concerning the power of the corporation to acquire its own shares (in general, only out of earned surplus, but in certain special situations notwithstanding this limitation), was amended to make clear that no purchase of its own shares shall be made at a time when the corporation is insolvent or if any such purchase would render the corporation insolvent.

Until 1957, no express provision had been made for the vacation of office by a registered agent. Section 11a was added to the act to cover the resignation of the registered agent of a domestic corporation and section 109a contained a similar provision with reference to registered agents of foreign corporations.

Section 14(b), which had permitted the creation of preferred shares entitled to cumulative or noncumulative dividends, was amended to provide that such dividends might also be partially cumulative.

Section 21, in addition to permitting the use on a share certificate of a seal or facsimile thereof which had been changed before the certificate was issued, was also amended to add as an alternative to the requirement that the certificate set forth a full or summary statement of the preferences and special rights of each class of shares and of each series, a provision that such statement may be omitted from the certificate if it shall be set forth on the face or back of the certificate that such statement in full will be furnished by the corporation to any shareholder upon request and without charge.

The amendment to section 22 permits a corporation to pay cash equal to the value of a fractional share in lieu of issuing scrip, and where scrip is issued, permits its sale by an agent on behalf of the holder thereof, as well as by the corporation.

The preemptive right of a shareholder to acquire additional shares except as limited or denied in the articles of incorporation was expressly made applicable by amendment to such additional shares "whether then or thereafter authorized," and this language was carried into section 47(k), setting forth the provisions of the articles of incorporation. The same amendment provided that the consideration fixed for par value shares offered to shareholders whether or not pursuant to preemptive rights may be in excess of the par value of shares.

Section 27, relating to notice, and section 29, involving the closing of transfer books and the fixing of the record date, were amended to conform to the requirement (therefore overlooked) that in the case of a merger or consolidation, the notice must be not less than twenty days before the date of the meeting.
Section 31, relating to a quorum of shareholders, adds the Model Act provision: "If a quorum is present, the affirmative vote of the majority of the shares represented at the meeting shall be the act of the shareholders, unless the vote of a greater number or voting by classes is required by this Act or the articles of incorporation or by-laws."

Section 33 was amended to provide that the articles of incorporation, as well as the by-laws, may prescribe qualifications for directors. There was also added to this section a provision following largely the Wisconsin Act that "unless otherwise provided in the articles of incorporation or by-laws, the board of directors, by the affirmative vote of a majority of the directors then in office, and irrespective of any personal interest of any of its members, shall have authority to establish reasonable compensation of all directors for services to the corporation as directors, officers, or otherwise." The language added eliminates any doubt as to the validity of such action by directors and confines any question to the reasonableness of the compensation.

Section 37 was amended so as to fix a quorum of directors at a majority of the total number of places on the board and not a majority of the directors then in office, unless a greater number is required by the articles of incorporation or by-laws.

An extensive amendment to section 38, concerning the appointment and powers of the executive committee, was adopted. Theretofore, the act had permitted the executive committee to have the authority of the board "in the management of the corporation..." There was some question whether this language granted to the executive committee authority such as the board had been given by a statute to amend the articles, adopt a plan of merger or consolidation, recommend sale, lease, mortgage, or other disposition of all of the corporate property, recommend voluntary dissolution or revocation thereof, amend or repeal the by-laws, elect or remove officers or members of the executive committee, fix compensation of any member of the executive committee, or declare dividends, and the amendment definitely answered this question in the negative.

Section 41b was added to forbid loans by a corporation to its officers or directors and also loans secured by its own shares. Loans to officers or directors had theretofore been forbidden by implication from section 42(d), which made any director assenting to such a loan liable to

19 Ill. Laws 1945, at 544.
the corporation for its repayment. One important purpose of the provision forbidding loans secured by the corporation's own shares is to eliminate the evasion of the provisions of section 18 that promissory notes shall not constitute payment for the shares of the corporation.

The amendment to section 44, striking out the words "elected or appointed by the board of directors,"²⁰ broadened the power of the board to remove an officer or agent of the corporation.

Section 45a was added to provide that no representative action shall be brought in this state by a shareholder of a domestic or foreign corporation unless the plaintiff was the holder of shares or of voting trust certificates therefore at the time of the transaction of which he complains or thereafter received them by operation of law from a person who was a holder at such time.

In *Duncan v. National Tea Co.*,²¹ an action instituted prior to the adoption of section 45a, the court held that in a derivative suit the plaintiff does not sue in an individual capacity, but as the representative of the corporation, and the decree is for the benefit of all shareholders except those who had actively participated in the wrong. A shareholder who acquired his shares after the occurrence of alleged acts of mismanagement is not barred from suing, if the alleged mismanagement and its effects continue and are injurious to him.²²

The procedure with reference to the amendments to the articles of incorporation as set forth in sections 52, 53, 54, 55, and 57 was amended to permit the restatement in a single instrument of the provisions of the articles of incorporation as then constituted or as further amended by such restatement, and the definition of "articles of incorporation" in section 2(c) was amended to include restated articles.

Section 58 was amended to prevent a reduction in stated capital in connection with the redemption or purchase and cancellation of a corporation's own shares until a report thereof had been filed.

Section 61, relating to merger, and section 62, relating to consolidation of corporations, added subsections providing that the plan might set forth provisions under which the proposed merger or consolidation

²⁰ Ill. Laws 1957, at 2192.
²² See also Lampropulus v. Kedzie Ogden Bldg. Corp., 4 Ill.2d 32, 122 N.E.2d 181 (1954), which held that a stockholder is bound by the action of the former owner of his shares and cannot complain of actions which had been consented to or participated in by his predecessor owner. The *Lampropulus* decision relied on Babcock v. Farwell, 245 Ill. 14, 91 N.E. 683 (1910).
might be abandoned prior to the filing of the articles by the Secretary of State.

Sections 70 and 73, setting forth the rights of dissenting shareholders, were each amended to provide that shares acquired from the dissenting shareholder may be held and disposed of by the corporation as in the case of other treasury shares.

Section 147, which had permitted action by the shareholders without a meeting by signing a consent in writing, was amended to provide expressly that such consent shall have the same force and effect as a unanimous vote of the shareholders and may be stated as such in any articles of incorporation or other document filed with the Secretary of State.

Section 35 was repealed in 1957 as a result of the decision in Wolfson v. Avery. In that case, the election of directors of Montgomery Ward and Company in 1955 precipitated the filing of the complaint by a shareholder seeking a declaratory judgment that section 35 of the Illinois Business Corporation Act, which purported to authorize the classification of directors into not more than three classes with the election of only one class annually, was unconstitutional and void, and that the company’s by-law adopted pursuant thereto was therefore unlawful. Montgomery Ward had a board of nine directors divided into three classes of three each. A judgment as prayed in the complaint was affirmed by the Illinois Supreme Court, Mr. Justice Hershey dissenting. The constitutional provision in question is section 3 of article XI of the Illinois Constitution, which reads:

The general assembly shall provide, by law, that in all elections for directors or managers of incorporated companies, every stockholder shall have the right to vote, in person or by proxy, for the number of shares of stock owned by him, for as many persons as there are directors or managers to be elected, or to cumulate said shares, and give one candidate as many votes as the number of directors multiplied by the number of his shares of stock shall equal, or to distribute them on the same principle among as many candidates as he shall think fit; and such directors or managers shall not be elected in any other manner.

The court upheld the contention that the purpose of the constitutional provision is to give minority shareholders the right to proportional representation on corporation boards, and brushed aside the contention that the purpose is to give minorities some representation, and that the corporation may reduce the number of its directors from

23 6 Ill.2d 78, 126 N.E.2d 701 (1955).
24 Ill. Const. art. XI, § 3. (Emphasis added.)
nine to three without violating any constitutional or statutory revision, in which event the number of shares required to elect a single director would be increased. The court also held, largely on the basis of extrinsic evidence consisting of statements made at the constitutional convention and in newspapers published at the time, that the words "to be elected" in the constitutional provision did not indicate that less than all directors might be elected at one time, but that the constitutional provisions required that the whole number of directors be elected at one time.

Apparently the majority opinion gave no consideration to interpreting the constitutional provision in the light of the ordinary meaning of the language used, that is to say, that each shareholder may give to one candidate as many votes as the number of directors (that is, the total number on the board—in this case, nine) multiplied by the number of his shares of stock shall equal, or that he may distribute them on the same principle among as many candidates as he shall think fit, and that the number of votes thus given to the shareholder should be cast for or distributed among the directors to be elected (in this case, three). This interpretation would be consistent with the approval given by a Chicago newspaper (relied on in other respects in the majority opinion) to the Corporation Act of 1872, which act—adopted immediately after the constitutional provision became effective—provided for classification of directors.

While it is true, as was contended by the complainant in this case, that dividing a board of nine into three classes of three each may deprive a minority shareholder able to elect one director out of nine (at an election of nine) of the right to elect any directors, it is to be noted that in some cases, if this construction were followed, the minority would profit from having staggered elections. To take a simple case, assume a corporation with 100 shares of stock—26 owned by one person and 74 by another—and a board of nine directors. The owner of 26 shares of stock is able to cast 117 votes for each of two directors or 78 votes for each of three directors. The owner of 74 shares may, however, cast 95 votes for each of seven directors. At an election of a board of nine, the minority shareholder may therefore elect only two. If, however, the board is divided into the three classes of three each, at every election the owner of 26 shares is able to cast 78 votes for one

25 The Chicago Tribune, April 5, 6, 1872.
26 Ill. Laws 1871–1872, at 2964.
director and the owner of 74 shares would be able to cast only 74 votes for each of three, and therefore at each election, the minority shareholder would be able to elect one out of three, with the net result that he would eventually be represented by three directors out of nine instead of two out of nine.

**1959 Amendments**

In 1959, section 29, relating to the closing of transfer books and the fixing of the record date, was amended by adding a sentence reading as follows: "When a determination of shareholders entitled to vote at any meeting of shareholders has been made as provided in this section, such determination shall apply to any adjournment thereof."

In 1959, section 29, relating to the closing of transfer books and the fixing of the record date, was amended by adding a sentence reading as follows: "When a determination of shareholders entitled to vote at any meeting of shareholders has been made as provided in this section, such determination shall apply to any adjournment thereof."

A number of bills were drafted by the Corporation Division of the Office of the Secretary of State to simplify procedure and eliminate difficulties that had arisen over the years in connection with documents filed in his office. These included more or less formal amendments to sections 13, 55, 95, 97, 107, 109a, 115 and 165.

_Sinclair Pipe Line Co. v. Carpentier,_27 involved the constitutionality of the sections of the act relating to annual franchise tax and increased license fee. The facts, either stipulated or admitted by the pleadings, disclosed that Sinclair was a Delaware corporation whose principal office was in Kansas, and that in 1952 it qualified to do business in Illinois as a corporation for the purpose of building, owning, and operating pipe lines, etc. Following its qualification and prior to 1935, it acquired lands and easements by eminent domain proceedings in order to accomplish its purpose. By January 1955, it owned and operated three pipe line systems originating in, and transversing Illinois, which were used solely for the transportation of oil through Illinois into Missouri. As an adjunct to its pipe lines, Sinclair maintained and operated communication systems by wire or radio and also had seven pumping stations at various sites along the three lines. These facilities were operated and maintained by seventy-three employees, all of whom were paid from the Kansas office. It was stipulated that Sinclair engaged in no intrastate business, and that all its activities and property in Illinois were devoted exclusively to the business of transporting oil or oil products in interstate commerce. The question involved was the payment of franchise tax and a small additional license fee for 1955. The tax and fee were required by the applicable sections to be assessed

27 10 Ill.2d 300, 140 N.E.2d 115 (1957).
upon the amount of stated capital and paid-in surplus represented in Illinois by that proportion of the sum of the stated capital and paid-in surplus which the sum of the value of the property located in this state, and the gross amount of business transacted by it at or from places of business in this state bore to the sum of the value of all of its property wherever located, and the gross amount of its business wherever transacted.

The latter formula had been approved by the Illinois Supreme Court and the United States Supreme Court as applied to foreign corporations engaged both in intrastate and interstate commerce in Illinois. Sinclair contended that it had paid an initial license fee at the time it qualified to do business in Illinois, but that it did no local or intrastate business, and was engaged exclusively in interstate commerce in Illinois in 1955, and was not liable for the franchise tax or additional license fee which had been assessed for that year. The Secretary of State advised Sinclair that the franchise tax would have to be paid unless Sinclair could withdraw from the state by filing an application prior to July 1, 1955. An application for withdrawal, however, must set forth "that no portion of its issued shares is on the date of such application represented by business transacted or property located in this State," and the Secretary of State refused to accept a modified form of withdrawal which added that the business was exclusively in interstate commerce and that the property was used exclusively in interstate commerce. Thereupon Sinclair paid the franchise tax and additional license fee under protest and commenced an action seeking a refund. The first question upon which the court passed was whether the franchise tax provided for in the act is imposed upon the privilege granted to a corporation to exist or to exercise its corporate functions in Illinois, or whether it is imposed upon the exercise of such privilege. The State contended that the corporation was liable whether or not the privilege was exercised. The court, holding that a distinction obtains between a license fee exacted for the privilege of doing business in the state and a franchise tax levied upon the exercise of the privilege granted, could find no basis for holding that all assessments have been lifted from the exercise of the privilege and tacked upon the granting of the privilege, and held that consequently no liability for franchise

28 Western Cartridge Co. v. Emmerson, 335 Ill. 150, 166 N.E. 501 (1929), aff'd, 281 U.S. 511 (1930).
tax could be said to have resulted from the mere granting of such unexercised privilege.

The court was next concerned with the question of whether or not the franchise tax may be imposed upon a foreign corporation when its privilege of doing business in the state is exercised exclusively in interstate commerce. The court reviewed the existing decisions, finding that the question was not entirely free from doubt, but holding that a franchise tax upon a foreign corporation engaged exclusively in interstate commerce is unconstitutional under the commerce clause.

The court also held that Sinclair could not properly withdraw from the state while admitting that it owned property in the state even though all such property was devoted exclusively to interstate commerce.

As a result of the Sinclair case, the Corporation Division of the Office of the Secretary of State drafted and caused to be introduced an amendment to section 135, inserting the words “for the privilege of exercising its authority to transact such business in this State as set out in its application therefor or any amendment thereto” before the words “the Secretary of State shall charge and collect from each foreign corporation the following license fees . . . ,” and inserting the same language in section 138 before the words “each foreign corporation shall pay to the Secretary of State the following franchise taxes . . . .” Similar language was also inserted at the beginning of sections 128 and 131, covering license fees and franchise taxes payable by domestic corporations.

There is considerable doubt, particularly on the question of constitutionality, as to whether or not the Secretary of State has accomplished what he sought to accomplish by these amendments. Unfortunately, at the same session of the Legislature, the Secretary of State caused another bill to be introduced which amended sections 131 and 138 in the same manner, and which also amended these two sections as well as sections 132 (basis for computation of franchise taxes payable by domestic corporations) and 139 (basis for computation of franchise taxes payable by foreign corporations) to provide that if a merger or consolidation becomes effective on or after January first and before July first of any year, the surviving or new corporation shall be liable for a further additional franchise tax (1) on the increased amount represented in this state of the resulting stated capital and paid-in surplus of the surviving corporation over the amount of its stated capital and paid-in surplus immediately prior to the merger, in the case of a
merger; or (2) on that portion represented in this state of the total stated capital and paid-in surplus of the new corporation, in the case of a consolidation. The additional tax is imposed, in either case, only on that part of the designated amount on which no annual franchise tax is paid or would otherwise be payable for the year commencing July first following said merger or consolidation, and on which no additional franchise tax is otherwise payable under the act. The corresponding amendment to sections 138 and 139 related only to mergers after January first, and not to consolidations. This bill was also enacted by the Legislature and signed by the Governor, with the result that there are two versions of sections 131 and 138.31

The Legislature in 1959 also enacted the Uniform Gift to Minors Act.32 which provides, among other things, that the custodian may vote, in person or by general or limited proxy, a security which is custodial property.33

**Case Law Changes**

**Interference with Internal Affairs**

In *Continental-Midwest Corp. v. Hotel Sherman, Inc.*33 a minority stockholder of Hotel Sherman, Inc., a Delaware corporation, all of the property of which was in Illinois and which transacted no business elsewhere, filed a representative action to enjoin the corporation from purchasing, acquiring, or exchanging shares of its stock, declaring dividends unless current assets exceeded current liabilities, contracting to merge with other corporations, and voting shares of its stock owned by a subsidiary, Ambassador East, Inc., also a Delaware corporation. The action of the chancellor with respect to all but the last portion, namely, the voting by the subsidiary (Ambassador East, Inc.) of shares of its parent (Hotel Sherman, Inc.), was reversed on the ground that the chancellor had abused his discretion in substituting his judg-

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31 The cases passing upon the effect of more than one amendment of a section in the same session of the Legislature are People *ex rel.* Schlaegar v. Mattes, 396 Ill. 348, 71 N.E.2d 690 (1947); S. Buchsbaum & Co., *v.* Gordon, 389 Ill. 493, 59 N.E.2d 832 (1945); People *ex rel.* Martin v. Village of Oak Park, 372 Ill. 488, 24 N.E.2d 571 (1939); People *ex rel.* Hines v. Baltimore & O. S. W. R.R., 366 Ill. 318, 8 N.E.2d 655 (1937).


34 From this point forward the authors discuss what seem to them to be the important decisions handed down during the decade being considered.

ment for that of the board of directors of the corporation, there having been no charge of fraud, oppression, or insolvency.

Hotel Sherman, Inc. owned approximately eighty per cent of the shares of Ambassador East, Inc. Ambassador East, Inc. owned twenty per cent of the shares of Hotel Sherman, Inc. This anomalous situation grew out of the reorganization of the predecessor of Hotel Sherman, Inc. by action of the Bankruptcy Court in 1937.

So much of the decision of the Appellate Court as reversed the chancellor, is justified by precedent and needs no discussion. However, in affirming the chancellor’s injunction restraining the voting by the subsidiary of the shares of its parent, the court disregarded section 102 of the act:

... A foreign corporation shall not be denied a certificate of authority by reason of the fact that the laws of the state under which such corporation is organized governing its organization and internal affairs differ from the laws of this State, and nothing in this Act contained shall be construed to authorize this State to regulate the organization or the internal affairs of such corporation.36

This language was incorporated in the statute for the first time in 1933. The discussion in the Illinois Business Corporation Act Annotated (2d ed.), edited by The Corporation Law Committee of the Chicago Bar Association, states in effect that the principle of the statutory enactment was theretofore established by a number of decisions. Whether or not this is so is now of no importance, except perhaps to aid in the construction of the language used in the statute, but the Appellate Court relied on Babcock v. Farwell,37 which obviously was decided prior to the change in the statute. Quite obviously, the court gave no effect to the statute or the opinions, which it is said state the same principle.

There is an apparent contradiction in the court’s opinion when it refers to “jurisdiction,” and this is not an uncommon difficulty. Obviously, the court held that the chancellor had jurisdiction (power to decide) the matter, but that it had abused its power, although the following is difficult to square with even this explanation:

Under the facts in this case, where all the actions complained of took place in Illinois, all the corporate assets are located in Illinois, all corporate business is done in Illinois, and all officers and directors reside in Illinois, it would be unjust to remand plaintiff to the courts of Delaware. We think justice, ex-

37 245 Ill. 14, 91 N.E. 683 (1910).
pediency, and the policy of Illinois compel the conclusion that the Chancellor
did not abuse his discretion through *undue interference in the affairs of the*
*Delaware corporations*.

The statute contains nothing about undue interference. It prohibits the
regulation of the internal affairs of a foreign corporation. Whether the
subsidiary should or should not be permitted to vote shares of stock of
its parent owned by it is certainly a matter of internal affairs. Later in
the opinion, the court stated, after holding that Delaware law did not
prohibit the payment of dividends when the current liabilities ex-
cceeded the current assets, and that in the absence of any fraud, op-
pression, or insolvency, there was no question but what the payment
of dividends should be left to the honest decision of the directors:

It is unfair to implicitly restrain the power of the majority stock held in the
voting trust which is unaffected by the question of the legality of Ambassador
voting Sherman stock. For this reason, we think the Chancellor abused his
discretion in restraining the payment of dividends and that part of the order
is invalid.

What we have said about the payment of dividends applies with equal force
to the purchase of outstanding stock of Sherman. . . . The same is true of that
part of the order restraining mergers.

**REDEMPTION PRICE OF PREFERRED STOCK**

*Bowman v. Armour & Co.*, involved a plan of recapitalization
amending the articles of incorporation by changing the provisions for
redemption of the prior preferred stock of Armour and Company.
The stock had a stated value of $100 per share and could be redeemed
at $115 per share plus accumulated dividends. The plan of recapitali-
ization provided that the prior preferred might be redeemed at $120
per share, payable in debentures of like principal amount subordinated
to other indebtedness of the company, and transferable warrants for
the purchase of one common share of the company at a price to be
determined by the directors. Section 52 provides that articles of in-
corporation may be amended to change the relative rights and prefer-
ences of all or any part of the corporate shares, but also provides that
the articles of incorporation, as amended, shall contain only such pro-
visions as might lawfully be contained in the original articles of incor-
poration. Section 14(a) provides for the issuance of preferred shares

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38 Continental-Midwest Corp. v. Hotel Sherman, Inc., 13 Ill. App.2d 188, 193, 141
N.E.2d 400, 402 (1957). (Emphasis added.)

39 Id. at 197, 141 N.E.2d at 404.

which may be redeemed “at not exceeding the price fixed by the
articles of incorporation. . . .” The court held that the word “price” as
used in the statute means money and not bonds or other evidences of
debt, and that the status of the holders of prior preferred stock cannot
be changed into that of creditors, even though the amendment was
approved by a vote of more than two-thirds of each class of outstand-
ing stock.

Another example of strict construction of a provision of the statute
is Odd Fellows Oak Ridge Cemetery Ass’n v. Oak Ridge Cemetery
Corp. An Illinois corporation organized under the general Corpora-
tion Act of 1872 was required to dispose of unneeded real estate, not-
withstanding the adoption of the Business Corporation Act of 1933,
which permits corporations to be organized with power to deal in real
estate without limitation. The more liberal attitude is found in Rock-
ford Life Ins. Co. v. Production Press, Inc. There it was held that a
corporation organized under the Business Corporation Act of 1919,
which provided that a change in the number of directors could only
be made by amendment of the articles of incorporation, could, after the
enactment of the Business Corporation Act of 1933—which provides in
section 34 that the number of directors may be increased or decreased
by amendment to the by-laws, and in section 25 that the power to
make or amend the by-laws shall be vested in the board of directors
unless reserved to the shareholders by the articles of incorporation—
increase the number of directors by adoption of an amendment to the
by-laws.

RIGHT OF DISSENT AND COURT APPRAISAL NOT EXCLUSIVE REMEDY

In Robb v. Eastgate Hotel, Inc., it was alleged that at a special
meeting of the stockholders of Eastgate called by its directors, the
corporation was authorized to sell its property to one Benjamin F.
Fohrman, for $550,000. Plaintiff’s theory was that the defendants, by
doubling expenditures for repairs and maintenance and otherwise mak-
ing it appear that the property was not profitable had acquired two-

42 Ill. Laws 1872, at 2964.
43 Ill. Laws 1933, at 310.
45 Ill. Laws 1919, at 312.
thirds voting control of Eastgate in order to accomplish their objective, namely, the sale to Fohrman at an inadequate price, the sale merely being for the benefit of the controlling syndicate. The court found that the offer was grossly inadequate. In recommending the sale of corporate assets and submitting it to a vote of shareholders, the directors are trustees of all of the shareholders and while the majority shareholders do not, by mere reason of their holdings, become trustees for the minority shareholders in voting on a sale of assets, equity will impose upon them the obligation of trustees if in forcing disposition of assets they overreach the minority shareholders and reap benefits in which the minority does not share. In actions of fraud against those not occupying a fiduciary relation, the fraud must be proved by those asserting it, but in actions against fiduciaries, as in sales of corporate property to directors, which are presumptively fraudulent, the burden is on the fiduciary to prove affirmatively compliance with equitable requisites to overcome the presumption of fraud. Directors of a corporation cannot purchase from themselves, and the rule has been applied to the extent that majority stockholders cannot overreach minority stockholders in authorizing a sale to themselves or to one who represents them. Defendants contended that under section 73, dissenting stockholders are limited to filing a written demand for the fair value of their shares within the time and with the effect set forth in said section. The court held that the provisions of section 73 do not furnish an exclusive remedy where, as here, charges of fraud and illegality are involved. Section 73 provides an adequate remedy where the dissenting stockholder's only complaint is the inadequacy of the price received and the only claim is money damages—the fair value of his shares. It is not a full and adequate remedy where fraud is charged, and in such case, the court may go beyond the mere assessment of damages and rescind the sale.

**FRANCHISE TAX OF FOREIGN CORPORATION**

The plaintiff in *U.S. Borax & Chemical Corp. v. Carpentier* was a Nevada corporation licensed to do business in Illinois. It had elected in its annual report filed in February 1956, to pay its franchise tax for the year beginning July 1, 1956, upon its entire stated capital and paid-in surplus. It was agreed between the parties that if plaintiff had elected to pay the franchise tax on the basis of the property located

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\(^{47}\) 14 Ill.2d 111, 150 N.E.2d 818 (1958).
within, and business transacted at or from places of business within the State of Illinois in accordance with section 139 of the Business Corporation Act, the ratio of property and business in Illinois would have been 93.57%. In May and June of 1956, plaintiff increased its aggregate stated capital and paid-in surplus from approximately $120,000 to $49,000,000. As of July 2, 1956, plaintiff was party to a merger, as a result of which its stated capital and paid-in surplus were increased by more than $4,000,000. Subsequent to these transactions, less than two per cent of the plaintiff's property and business was located in or transacted from places within the State of Illinois.

On June 30, 1956, the changes in stated capital and paid-in surplus were reported to the Secretary of State of Illinois, and plaintiff also filed an amended annual report and a report of change in capital and surplus as a result of the merger and of its obligation to issue additional shares on July 2, 1956. The Secretary of State was upheld in his contention that under section 139, no amended annual report could be filed after June 25, 1956, and as a result, the franchise tax was based upon plaintiff's election in its annual report to be taxed upon its entire stated capital and paid-in surplus.

In passing upon the contention that a state may not compel a foreign corporation to submit to a tax based solely upon its interstate business or property located outside of the state, the court held that it is not per se unconstitutional to include some out-of-state property or business so long as the formula used to determine the tax basis has the purpose of arriving at a fair conclusion as to the value of intrastate business of a corporation. The plaintiff had failed to file an amended annual report within the period limited by section 139. Had it consummated its merger before July 1, 1956, it might again, under that section, have limited its additional franchise tax to the portion of property reported in Illinois, as shown by the articles of merger. Having failed to do this, and having elected in its annual report to pay its tax on the basis of its entire stated capital and paid-in surplus, the corporation was estopped from claiming otherwise.

It is to be noted that the annual report, as provided in section 115(1), must set forth the proportion of property and business in Illinois as of December 31st of the preceding year, and that in the U.S. Borax case had it not been for the merger, the portion allocated to Illinois would have been 93.57%. The court held that the issue as to whether or not plaintiff might have had a remedy under these circum-
stances was purely speculative and not presented by the facts of the case.

*Jorgensen v. Baker*\(^{48}\) held that under section 142, a corporation which is delinquent in the payment of franchise taxes, but has started a suit, may, by subsequent compliance with the statute, continue the prosecution of the suit. This rule, however, does not apply when the statute of limitations has run before the corporation reacquires the right to use the courts of this state.

**EXTENSION OF THE VOTING TRUST**

Section 30a, added to the act in 1947, provides that any number of shareholders of a corporation may create a voting trust for a period of not exceeding ten years. There is no provision for extension.

*Thomas v. 4145 Broadway Hotel Co.*\(^{49}\) held that although an amendment of a stock voting trust agreement extending the duration of the trust was invalid, and the trust terminated on an earlier date specified in the original agreement, it was entirely lawful for the owners of trust shares to voluntarily permit the trustees to continue to remain the registered owners of ninety-nine per cent of the shares of stock and to vote the shares in accordance with the express provisions of the trust certificates and the trust agreement. It is to be noted that in this case the plaintiff had waited until almost two and one-half years after the extension was declared effective before instituting suit, and in the meantime had acquiesced in the actions of the trustees by accepting the benefits of substantial liquidating dividends declared by the trustees.

*Oppenheimer v. Cassidy,*\(^{50}\) involved an agreement by holders of a majority of shares issued under a voting trust created in connection with a plan for reorganization of a corporation to extend the duration of the trust for an additional ten years. This agreement, the court held, did not violate section 30a. Upon termination of the original voting trust, shareholders had a right to enter into an agreement between themselves to extend the trust or to make a new voting trust agreement with the same provisions as the expired trust, and such agreement, whether called an extension of the voting trust, or a new voting trust, was binding on only those who agreed to be bound.


\(^{50}\) 345 Ill. App. 212, 102 N.E.2d 678 (1951).
THE EXECUTIVE COMMITTEE

The president of a corporation, being disqualified as a director from voting on a resolution to grant himself additional compensation for services rendered to the corporation, attempted to accomplish his ends by designating an executive committee. The by-laws authorized the creation of a committee composed of men to be selected by the president of the corporation, and the members selected by the president were not directors of the corporation. The court in *Steigerwald v. A. M. Steigerwald Co.* held that the by-laws were not in compliance with section 38, which required that the members of the executive committee be selected by the directors, and that all members of the executive committee be directors.

POWERS OF OFFICERS AND AGENTS

*Sacks v. Helene Curtis Indus., Inc.*, held that the president of a corporation has no implied authority to make a contract on its behalf which is unusual and extraordinary. And a contract to pay as compensation a percentage of the profits of the corporation is not the usual and ordinary contract which one authorized to employ on behalf of the corporation may make without specific authority. A similar conclusion was reached in *Goodman v. Motor Prods. Corp.*, in spite of the fact that the extraordinary contract had been in effect for more than ten years. There, the agent of the defendant corporation had given the plaintiff an oral exclusive sales and distribution contract to sell food freezers manufactured by the defendant corporation under the trade name of "Deepfreeze" in territory outside the United States. The agreement required plaintiff to give up his other business ventures, and was to continue so long as he devoted his full time and attention to the selling and distribution of these electrical appliances. The agreement granted him the right to set up corporations containing the word "Deepfreeze" in their names so long as they did not handle a competing product. The court held that the agent had no express authority to give away the corporation's property and that there was no implied authority in a department head or even a general manager to contract to give another an interest in his principal's property or business. While the contract had been in effect for more than ten years, it was

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denied that its extraordinary terms and conditions had ever been brought to the attention of the officers or directors of the defendant corporation.

DIVIDENDS ON NON-CUMULATIVE PREFERRED

In Guttmann v. Illinois Central R.R., the court assumed for the sake of argument that the standard of discretion in waiving the propriety of the non-declaration of dividends on non-cumulative preferred stock is far stricter than in the case of the non-declaration of dividends on common stock. It held, nevertheless, that in the case of an Illinois corporation where the net earnings for a given year are legitimately retained for any one of a variety of corporate purposes, the directors have not abused their discretion in not declaring dividends on non-cumulative preferred and have no power in subsequent years to declare dividends for the years in question. (In the Guttmann case, defendant's net income in each year from 1937 to 1947 inclusive exceeded the annual dividend on the non-cumulative preferred shares, but no dividends for those years were ever declared. In 1948 to 1950 inclusive, the directors declared a dividend on the preferred stock for each such year, and in 1950, also declared a dividend on the common stock.)

THE RIGHT TO A LIST OF SHAREHOLDERS

The president of the corporation who was the owner of seventy per cent of its stock used the stockholders’ list to submit to the stockholders an offer of fifty dollars per share. The plaintiff in Crouse v. Rogers Park Apartments, Inc., was the owner of five shares. Upon receiving the offer, she requested the stockholders' list for the purpose of offering sixty dollars per share to all stockholders. The president refused to give her the list. A stockholder seeking to examine the books and records of a corporation must allege and prove a proper purpose under section 45. A proper purpose is one in which the stockholder seeks information bearing upon the protection of his interest and that of other stockholders. In this case, the court said that the stockholder did not appear to be a speculator, since she had purchased

54 189 F.2d 927 (2d Cir. 1951), cert. denied, 342 U.S. 867 (1951), Annot., 27 A.L.R.2d 1066 (1953).

her stock about three years before she received the president's offer; but the court added, that even assuming there was speculation on her part, the president could not use the stockholders' list to do his own trading and deny it to other stockholders.

The right of an individual director of a corporation to have a copy of auditor's reports regardless of whether executive officers wish such director to have a copy, was upheld in Kunin v. Foreman Realty Corp.\(^6\)

**CORPORATE MINUTES**

*Field v. Oberwortmann\(^5\)* held that the secretary of a corporation is under obligation to keep the minutes faithfully, but is not obligated to include everything that is said, as long as he transcribes accurately what has taken place.

**A SHAREHOLDER'S DERIVATIVE ACTION**

While a demand on the board of directors of an Illinois corporation is a condition precedent to a shareholder's filing a derivative action on behalf of the corporation, the board's refusal to act does not in itself clear the way for suit, and if a board, a majority of which are admittedly honest and have not been involved in the alleged wrongs, refuses a demand to bring suit, the complaining shareholder has no standing to commence a derivative suit.\(^5\)

**TERM OF OFFICE OF A DIRECTOR**

A corporation with four directors had held no election of directors for several years. Three of the four directors resigned, and a meeting was called to fill the vacancies caused by their resignations. The holders of sixty per cent of the stock of the corporation nominated three directors, who were unanimously elected. If an election had been held for four directors, the holders of sixty per cent of the stock would not have been able to elect three of the four if there had been five candidates for the four directorships, since the result would have been a deadlock. Under section 34 and the by-laws, the terms of all directors had expired, and therefore no director could be elected to fill the vacancy for the unexpired term of his predecessor, as provided

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Swanson v. Traer, 249 F.2d 854 (7th Cir. 1957).
in section 36. The court in *Levin v. Hunter* held that there should have been an election of four directors, but the stockholders, having freely participated in the election of three directors, were bound thereby, and equity would not aid them to force a deadlock and dissolution on the majority stockholders.

**MINORITY VS. MAJORITY SHAREHOLDERS**

The corporation involved in *Hyman v. Velsicol Corp.*, had been organized to exploit inventions of a minority shareholder who had been general manager from the inception of the corporation, but had resigned as vice president, manager, and director, and had taken about thirty of the corporation's fifty technical employees with him to establish a competing corporation. At a shareholders meeting of which the minority shareholder had notice, resolutions for a recapitalization program were approved by the requisite vote and there was no recommendation of a substitute plan although the minority shareholder was represented at the meeting by an attorney as his proxy. The majority plan decreased the par value of the corporation's stock from one hundred to ten dollars per share, and increased the number of shares from 200 to 2,000. The charter amendment authorized 100,000 shares of common stock of ten dollars par value, and the plan authorized the issuance of 68,000 additional shares to be paid for at par in cash or by credit against sums owed by the corporation on outstanding notes, the period within which payment was to be made being approximately ten days. The minority shareholder was not deprived of his right to a proportionate share of the new stock issue at the new par value, his rights having been protected by the issuance to him of the additional shares arising from the stock split and subscription warrants. The majority were not responsible for his failure (because of lack of funds) to avail himself of his preemptive rights, and the increase in the number of shares to be issued and the fixing of a date on which subscription should be paid for in full was not an abuse of discretion of the majority of shareholders and was not fraudulently oppressive to the minority shareholder.

It must be recognized that the action of the minority shareholder in organizing a competing corporation may have had a bearing on the court's decision.

Another case in which the minority shareholders attempted to use their position to secure an advantage over the majority was *Chapman v. Barton*.\(^1\) When, at the annual meeting of shareholders, which had customarily been conducted in an informal manner by oral vote, one of the shareholders demanded a vote by ballot, the chairman stated that he would not conduct a meeting without legal advice, and adjourned it until a lawyer could be consulted. The minority held a meeting and elected directors whose right to act, as well as the right of officers elected by them to act, was questioned in this litigation. The court held that the minority shareholders could not complain that the annual meeting was adjourned without electing directors where no attempt was made to deprive the minority of their rights and it was understood that there was to be another meeting for the election of directors. Courts of equity do not look with favor upon attempts of a minority group to seize control of a corporation by trying to trap the majority which is without legal advice. The court also held that corporate minutes prepared by each faction after the annual meeting amounted to nothing more than self-serving statements made out of court by interested parties, and could not be accorded weight for either side against testimony of witnesses sworn and examined in court.

**FIDUCIARY OBLIGATION OF DIRECTORS**

*Shlensky v. South Parkway Bldg. Corp.*\(^2\) is the first of three opinions involving the same parties and the same situation. To the complaint alleging misconduct on the part of the majority stockholders, a verified answer was filed denying the material allegations of the complaint and charges of wrongdoing. The order for a temporary injunction was reversed on the ground that the court was satisfied that the issues could not be determined without the hearing of testimony.

After the case was tried, the Appellate Court\(^3\) again reversed the master and the chancellor on the authority of *White v. Stephens*,\(^4\) in which the following appeared:

\(^1\) 345 Ill. App. 110, 102 N.E.2d 565 (1951).
\(^2\) 350 Ill. App. 293, 112 N.E.2d 716 (1953).
\(^4\) 326 Ill. 528, 158 N.E. 101 (1927).
There is no presumption in such case [where corporations with common directors deal without an independent and disinterested majority] that the contract is unfair or oppressive but the person attacking it must prove its unfairness.65

On leave to appeal, the Supreme Court reversed the Appellate Court, affirmed the chancellor, and held that since the transactions complained of were between corporations, the common directors of which dominated both corporations, the defendant had the burden of establishing the fairness of the transaction, and since the defendant had not sustained that burden, the Appellate Court's decision was erroneous.66

The Supreme Court relied on Geddes v. Anaconda Copper Mining Co.,67 in which it was said:

The relation of directors to corporations is of such a fiduciary nature that transactions between boards having common members are regarded as jealously by the law as are personal dealings between a director and his corporation, and where the fairness of such transactions is challenged the burden is upon those who would maintain them to show their entire fairness...68

THE POWER TO AMEND A CHARTER CHANGING PREFERENCES OF PREFERRED SHAREHOLDERS

While the decision of Western Foundry Co. v. Wicker69 was decided prior to the period dealt with in this article, it is a case of prime importance and worthy of a short comment. In that case, the corporation's charter provided that the holders of preferred shares were entitled to receive preference dividends and to enjoy other preferences in the distribution of assets, etc. At a special shareholders meeting, all of the shareholders, both common and preferred, except the complaining preferred shareholder, voted to amend the charter so that the preferred shares would be non-cumulative as to future dividends, and they cancelled all unpaid accumulated dividends. Statutory provisions for passing the amendment were followed. The corporation then filed its action for a declaratory judgment that the amendment to the charter was valid. The court held for the plaintiff and stated that the claim of the dissenting preferred shareholder that his "vested" right had been impaired or destroyed was without basis in law.

65 Id. at 533, 158 N.E. at 103.
67 254 U.S. 590 (1921).
68 Id. at 599.
In a well-reasoned opinion, the court held that since the original charter provided that the rights and preferences of the preferred shares might be changed by a vote of two-thirds in amount of the preferred shares and, of course, concurrence of the common shares, both of which had been had, the amendment to the charter was valid and did not violate any of the rights of the dissenting preferred shareholder. After reviewing the English cases and those in other United States jurisdictions, the court, through Judge Wilson, said:

The same contract creating the right to accrued cumulative dividends may, by other terms and conditions, render the right defeasible by appropriate action of the majority of the members of the corporation. Furthermore, although an amendment cancelling accrued dividends appears to have a retroactive effect, its actual operation is prospective only. The accrual of dividends by the mere lapse of time does not alter the nature or character of the dividend rights of preferred stock. Where a corporation fails to declare a dividend on its preferred stock, the only change effected is an enlargement of the size or quantity of the right to dividends. The character of the right remains unchanged and continues to be prospective. Lastly, it should be observed that the charter provision authorizing a change in the rights of the preferred stock itself creates a contractual right in the shareholders and it is the validity of a proper exercise of this right to change the defeasible right of the preferred stock which is here sustained.\(^7\)

\(^7\) Id. at 283, 85 N.E.2d at 733.