

2007

William J. Cowan, as administrator with the will annexed of the estate of Ethelbell M. Harmon, deceased, Richard H. Mumper, Edwin A. Meserve, Shirley E. Meserve, William J. Cowan, Lesley D. W. Riter, Edna Dayton, Damaris A. beeman, Tracy-Collins Trust company, a corporation, Beneficial Life Insurance Company, a corporation, Sarah Daft Home, a corporation, R.C. Granville, and J.E.

Benedict, on behalf of themselves and all other holders of Class 2 Preferred Stock of Salt Lake

Hardware Company, a Utah Corporation v. Salt Lake Hardware Company, a corporation; Brief of Appellant

Franklin Riter; Ashby D. Boyle; Attorneys for Appellants.  
Utah Supreme Court  
Dey, Hoppaugh, Mark and Johnson; Attorneys for Respondent.

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#### Recommended Citation

Brief of Appellant, *Cowan v. Salt Lake Hardware Company*, No. 7463.00 (Utah Supreme Court, 2007).  
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ET NO. 7463 PI

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# of the State of Utah

WILLIAM J. COWAN, as administrator  
with the will annexed of the estate of  
Ethelbell M. Harmon, deceased, RICH-  
ARD H. MUMPER, EDWIN A. ME-  
SERVE, SHIRLEY E. MESERVE, WIL-  
LIAM J. COWAN, LESLEY D. W.  
RITER, EDNA DAYTON, DAMARIS A.  
BEEMAN, TRACY-COLLINS TRUST  
COMPANY, a corporation, BENEFICIAL  
LIFE INSURANCE COMPANY, a cor-  
poration, SARAH DAFT HOME, a cor-  
poration, R. C. GRANVILLE, and J. E.  
BENEDICT, on behalf of themselves and  
all other holders of Class 2 Preferred  
Stock of Salt Lake Hardware Company,  
a Utah Corporation,

*Plaintiffs and Appellants,*

— vs. —

SALT LAKE HARDWARE COMPANY,  
a corporation,

*Defendant and Respondent.*

Case No.  
7463

## BRIEF OF PLAINTIFFS AND APPELLANTS

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## TABLE OF CONTENTS

	Page
PRELIMINARY STATEMENT .....	2-3
STATEMENT OF FACTS .....	3-17
RELEVANT CONSTITUTIONAL PROVISION .....	17-18
SATUTORY REFERENCES .....	18-22
STATEMENT OF ARGUMENT: .....	22
I. The reserved power of amendment contained in the Constitution of the State of Utah and implemented by Sec. 338, Title 11, Chap. 1, R. S. of Utah 1898 (Operative on date of incorporation of defendant) and Sec. 18-2-44, Utah Code 1943, (Operative on date of the questioned amendment to defendant's articles of incorporation) did not authorize the amendment to defendant's articles of incorporation converting non-callable and non-redeemable preferred stock to callable and redeemable preferred stock.....	22
1. The power reserved by the State of Utah in its Constitution and Statutes to amend, alter or repeal all laws relating to corporations was the result of the Dartmouth College case, and such reservation was and is intended to eliminate the results of said decision. ....	23-30
2. The reservation of power to amend, alter or repeal corporation laws protect the relationship between the state and the corporation and is to be exercised in matters of public concern and welfare. The reservation of power when properly construed does not appertain to the relationship between the corporation and its stockholders or between the stockholders inter se.....	30-45
II. The phrase "may be amended in any respect," contained in Sec. 338, R. S. 1898 and in Sec. 18-2-44, U. C. 1943, is not unlimited in its operation and must be circumscribed by an interpretation and construction which will protect the rights of minority stockholders from oppression and abuse of power by the majority of stockholders. ....	45
1. Changes in the rights of outstanding shares of corporate stock can be justified under said statutes only when the exigencies and needs of the corporation require it. ....	53-55
2. The exercise of the reserved power to amend, alter or repeal by a majority of stockholders of a corporation should never be sustained when such exercise of power substantially impairs the rights of minority stockholders. ....	55-65

## INDEX OF CASES CITED

	Page
A. C. Frost & Company v. Coeur d'Alene Mines Corporation, (1939) Idaho 92 Pac. (2d) 1057 .....	38

	Page
Breslav v. New York & Queens Electric Light & Power Company, (1936) 249 App. Div. 181, 291 N. Y. S. 932; (1937) 273 N. Y. 593, 7 N. E. (2d) 708.....	36
Consolidated Film Industries v. Johnson, (1937) Del. 197 Atl. 489 .....	36
Coombs v. Getz, 285 U. S. 434, 52 S. Ct. 435, 76 L. Ed. 866....	39
Dartmouth College v. Woodward, 4 Wheat. (U. S.) 418, 638, 643; 4 Law Ed. 629.....	23, 27, 28, 30
DeMello v. Dairyman's Cooperative Creamery, 73 C. A. (2d) 746, 167 Pac. (2d) 226.....	47, 50, 54
Fidelity Building and Loan Assn. v. Thompson, 51 S. W. (2d) 578, 599 .....	40
Fower v. Provo Bench Canal and Irrigation Company, 99 Utah 267, 101 Pac. (2d) 375.....	65
Garey et al v. St. Joe Mining Company, 32 Ut. 497, 91 Pac. 369, 12 L. R. A. (N. S.) 554 .....	30, 31, 32, 37
Havender v. Federal United Corporation (1940), 24 Del. Ch. 318, 11 At. (2d) 331 .....	52
Hottenstein v. York Ice Machinery Corporation, 136 Fed. 2d (C. A. 3d Del.) 944 .....	52
Johnson v. Tribune-Herald Company, 155 Ga. 204, 116 S. E. 810 .....	38
Kamena v. Janssen Dairy Corporation (1943), 133 N. J. Equity 214, 31 At. 2d 200, 134 N. J. Equity 359, 35 At. 2d 894 .....	52
Keller vs. Wilson & Company, (1936) Del. 190 Atl. 115; (Delaware Chancery Court) 180 Atl. 584.....	35, 36
Langfelder v. Universal Laboratories, (C. A. 3d Del.) 163 Fed. 2d 804 .....	52
Lord v. Equitable Life Assurance Society of the United States, 194 N. Y. 212, 237; 87 N. E. 443; 22 L. R. A. (NS) 420 .....	37
Midland Co-op Wholesale v. Range Co-op. Oil Assn., 200 Minn. 538, 274 N. W. 624, 111 A. L. R. 1521.....	39
Norris vs. American Pub. Utilities Co. (1923) 14 Del., Ch. 136, 122 A. 696 .....	33
Page v. American and British Manufacturing Co., 129 App. Div. 346, 113 N. Y. S. 734.....	37
Porges v. Badsco Sales Corporation, 1943, 32 At. (2d) (Del. Ch.) 148 .....	52
Prohic v. Spirits Distributing Company, (1899) 58 N. J. Eq. 97, 42 At. 586 .....	35
Re Western Grocers (1936; Manitoba) 2 West. Week. Ret. 81, 2 D. L. R. 762.....	48
Salt Lake Automobile Company v. Keith O'Brien Company, 45 Utah 218, 143 Pac. 1050.....	60, 63, 64
Strout v. Cross A and I Lumber Co., 283 N. Y. 406, 28 N. E. (2d) 890, 133 A. L. R. 646.....	40

## INDEX OF CASES CITED (Continued)

	Page
Sutton v. Globe Knitting Works, 276 Mich. 200, 267 N. W. 815, 105 A. L. R. 1447, 1451.....	37, 41
Vanden Bosch v. Michigan Trust Co., 35 Fed. (2d) 643, 645....	41
Weed v. Emma Copper Company, 58 Utah 524, 200 Pac. 517 .....	60, 62, 63, 64
Wessel v. Guantanamo Sugar Company, 134 N. J. Equity 271, 35 At. 2d 215, 135 N. J. Equity 506, 39 Atl. 2d 431....	52
Yoakam v. Providence Biltmore Hotel Company, (1929) D. C. 34 Fed. (2d) 533.....	34, 37

## INDEX OF TEXTS CITED

	Page
13 Am. Jur. Corporations, Sec. 90, p. 234.....	49
13 Am. Jur. Corporations, Sec. 424, p. 476.....	50
12 C. J., Sec. 648, pp. 1023-24.....	26
14 C. J., Sec. 194, pp. 189-190.....	27
California Corporation Law, 1949 Ed. ....	46
3 Clark & Marshall, Private Corporations, Sec. 631f.....	25, 29
Cook on Corporations, Fifth Ed., Sec. 501.....	30
13 Fletcher Cyclopedia Corporation—Permanent Edition— Sec. 5776, pp. 85-87.....	25
Thompson on Corporations, Third Ed., Sec. 431, pp. 545-546....	28
Thompson on Corporations, Third Ed., Sec. 438, pp. 555-556....	29

## INDEX OF STATUTES CITED

Compiled Laws of Utah 1917, Sec. 886.....	20, 21
Constitution of the State of Utah, Art. XII, Sec. 1.....	18, 30
Federal Constitution, Art. I, Sec. 10.....	31
Federal Constitution, 14th Amendment .....	32
Laws of Utah, 1896, p. 30 (Sec. 2273) .....	31
R. S. 1898, Sec. 338, Tit. 11, Ch. 1.....	18, 19, 20, 30, 31, 50, 65
R. S. 1898, Sec. 338 and 339.....	16
Session Laws of Utah 1903, Ch. 94, Sec. 338.....	19
Session Laws of Utah 1905, Ch. 131, Sec. 338.....	19
Session Laws of Utah 1919, Sec. 886.....	20, 21
Session Laws of Utah 1921, Ch. 22, Sec. 886.....	20, 21
Utah Code Annotated 1943, Sec. 18-2-44.....	21, 30, 65
Utah Constitution, Art. I, Sec. 7.....	32
Utah Constitution, Art. I, Sec. 18.....	31

# In the Supreme Court of the State of Utah

WILLIAM J. COWAN, as administrator  
with the will annexed of the estate of  
Ethelbell M. Harmon, deceased, RICH-  
ARD H. MUMPER, EDWIN A. ME-  
SERVE, SHIRLEY E. MESERVE, WIL-  
LIAM J. COWAN, LESLEY D. W.  
RITER, EDNA DAYTON, DAMARIS A.  
BEEMAN, TRACY-COLLINS TRUST  
COMPANY, a corporation, BENEFICIAL  
LIFE INSURANCE COMPANY, a cor-  
poration, SARAH DAFT HOME, a cor-  
poration, R. C. GRANVILLE, and J. E.  
BENEDICT, on behalf of themselves and  
all other holders of Class 2 Preferred  
Stock of Salt Lake Hardware Company,  
a Utah Corporation,

*Plaintiffs and Appellants,*

— vs. —

SALT LAKE HARDWARE COMPANY,  
a corporation,

*Defendant and Respondent.*

Case No.  
7463

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## BRIEF OF PLAINTIFFS AND APPELLANTS

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## PRELIMINARY STATEMENT

This action was commenced and prosecuted in the District Court of the Third Judicial District of the State of Utah, in and for Salt Lake County, by owners of second preferred shares of the defendant corporation to secure an adjudication by the courts of the right of the defendant to call for redemption and to redeem said shares of stock. The complaint states three causes of action. By the first and third causes, plaintiffs seek to have declared null and void and without legal effect a purported amendment to the articles of incorporation of defendant, whereby it is sought to make said preferred shares redeemable at the pleasure of the Board of Directors of defendant, and to restrain and enjoin the defendant company, its officers, and directors from redeeming or retiring, or attempting to redeem and retire, said shares of second preferred stock owned by the plaintiffs and one other owner who is not a party to this action. By the second cause of action, plaintiffs seek a judgment declaring the rights of the plaintiffs and owners of said preferred shares and the rights and duties of the defendant in respect thereto and, in particular, the plaintiffs ask that the judgment declare the said purported amendment to the articles of incorporation of the defendant null and void insofar as it affects the shares of preferred stock now issued and outstanding. The three causes of action allege in general the identical facts, and they differ only with respect to the legal theory and conclusions the pleader deduced from them.

At the trial each of the parties moved for judgment on the pleadings. (R. 51, 52.) The fundamental facts were not in dispute. The denials and traverses found in the pleadings are denials of legal conclusions of the opposing pleader, and are not denials of material facts, concerning which there was and is no controversy.

The trial court granted the motion of defendant and denied plaintiffs' motion (R. 63), and thereafter, formal judgment, bearing date of January 6, 1950, denying plaintiffs' motion and granting defendant's motion and adjudicating the controversy in defendant's favor, was signed, entered and filed. (R. 53, 54.) The plaintiffs appealed to the Supreme Court from this judgment. (R. 64, 65, 66, 67, 68, 69.)

### STATEMENT OF FACTS

1. For a considerable period of time prior to November 10, 1947, there were twelve persons and corporations the owners and holders of 1826 shares of class 2 preferred stock of the defendant corporation. At the time of the commencement of this action a total of 1501 shares were owned and held by the plaintiffs in this action, in the several separate ownerships alleged in Paragraph IV of the complaint. (R. 02.) One A. F. Tilton owned 325 shares, but she did not join in this action. While this action was pending, one of the plaintiffs, Ethelbell M. Harmon, sold and transferred on the books of the company 50 shares of her stock to Edna Dayton, one of the original plaintiffs, 25 shares to R. C. Granville, and 25 shares to J. E. Benedict. (R. 44, 45.)



By order of Court made, entered and filed on December 28, 1948, the said Granville and Benedict were made parties plaintiff in this action. (R. 42, 43.) The consequence of the transactions above related was to reduce the ownership of Harmon's shares to 800; increase Dayton's shares to 58; and add Granville and Benedict as owners of class 2 preferred stock, each with ownership of 25 shares. The total number of shares, viz. 1501, involved in this action, therefore remains the same. (R. 44, 45.)

During the pendency of this action, to-wit on the 24th day of March, 1949, the plaintiff Ethelbell M. Harmon died in Los Angeles, Los Angeles County, State of California. Upon application of Edwin A. Meserve, the regularly appointed, qualified and acting Executor of the Estate and under the Last Will and Testament and codicils thereto of said Ethelbell M. Harmon, deceased (said appointment having been made in the Superior Court of the State of California in and for Los Angeles County), made and filed in the District Court of the Third Judicial District of the State of Utah, in and for Salt Lake County, Probate Division, and after due notice thereon, the said Last Will and Testament and codicils thereto of said deceased were admitted to probate in the last mentioned Court, and WILLIAM J. COWAN, of Salt Lake City, Salt Lake County, Utah, was appointed Administrator with the Will annexed of the estate of said deceased. Said Cowan qualified as such administrator with the will annexed. Based upon stipulation of the parties hereto, the above entitled

Court did by Order made, entered and filed on the 28th day of June, 1949, substitute said WILLIAM J. COWAN, in his capacity aforesaid, as a party plaintiff in lieu of said Ethelbell M. Harmon, deceased, and the said Cowan, in his capacity aforesaid, did by formal instrument join in and adopt the allegations of the complaint in the above entitled action. (R. 46, 47, 48, 49, 50.)

This action was instituted and prosecuted as a representative action on behalf of all owners and holders of Class 2 preferred stock of the defendant corporation. That the present share ownership of the plaintiffs is as follows:

Ethelbell M. Harmon, deceased.....	800 shares
Richard H. Mumper .....	17 shares
Edwin A. Meserve .....	58 shares
Shirley E. Meserve .....	25 shares
William J. Cowan .....	50 shares
Lesley D. W. Riter.....	50 shares
Tracy-Collins Trust Co. ....	9 shares
Beneficial Life Insurance Co.....	100 shares
Sarah Daft Home .....	275 shares
Edna Dayton .....	58 shares
Damaris A. Beeman .....	9 shares
R. C. Granville .....	25 shares
J. E. Benedict .....	25 shares
	(R. 44, 45)

2. After the commencement of this action, at a special stockholders' meeting of the defendant corporation properly convened at Salt Lake City, Utah, on March 16, 1948, the Articles of Incorporation of the defendant corporation were amended so as to extend the corporate life for a period of five years after April 2,

1948. Proper certificate of amendment was filed by the defendant with the County Clerk of Salt Lake County, Utah, and a copy of the certificate of amendment, duly certified by the said County Clerk, was filed in the office of the Secretary of State of the State of Utah on March 17, 1948. All of the shares of stock owned by the plaintiffs herein were voted in favor of adoption of said amendment extending the corporate life of the company. (R. 39, 40, 41.)

3. The defendant was organized as a corporation under the laws of the State of Utah on the 4th day of April, 1898, and Certificate of Incorporation was issued by the Secretary of State of the State of Utah on that date. (R. 03.) The capital of said company was fixed in the sum of \$200,000.00, divided into 750 shares of the par value of \$100.00 each of 10% non-callable preferred stock having a total par value of \$75,000.00; and 1,250 shares of a par value of \$100.00 each of common stock having a total par value of \$125,000.00. The original Articles of Incorporation provided:

“Upon dissolution of this corporation, after the payment of all its debts, the remaining assets shall be divided among the different classes of stockholders according to their preferences, that is to say: the preferred stock shall first be paid in full, and the balance divided among the common stockholders pro rata.” (R. 03.)

The duration of said corporation was for the period of 50 years from and after date of incorporation. (R. 03.) The articles of incorporation on their face carried no provision with respect to authority of the stockholders

to amend the same. (R. 03.) The right of amendment, if it exists, was and is dependent upon relevant statutory provisions. Therefore, the denial of the defendant of the allegation contained in Paragraph V of the first cause of action (R. 22), to-wit:

“Said original articles of incorporation were silent with respect to authority of the stockholders to amend the same.” (R. 03.)  
is in effect the denial of a legal conclusion.

4. On December 7, 1900, there was filed in the office of the County Clerk of Salt Lake County, Utah, an amendment to the articles of incorporation of the company (and a certified copy thereafter on December 11, 1900, was filed in the office of the Secretary of State of the State of Utah, and on said last mentioned date the Secretary of State issued his Certificate of Amendment) whereby the capital stock of the company was increased to the amount of \$750,000.00, divided into 75,000 shares, each of \$100.00 par value. Of said amount \$500,000.00 was represented by 5,000 shares of common stock, and \$250,000.00 was represented by 2,500 shares of preferred stock. The preferred stock was further subdivided into 750 shares of class 1 preferred stock possessing a total par value of \$75,000.00 and entitled to a preference over all other classes of stock of the company of 10% cumulative dividends, and 1,750 shares of class 2 preferred stock with a total par value of \$175,000.00 and entitled to a preference over the common stock of 6% cumulative dividends. There was no express provision in said amendment making said preferred shares redeemable

or callable. The defendant admits this statement, but alleges as a legal conclusion that the stock above described was callable and redeemable. (R. 03, 04, 26.)

5. On April 20, 1907, after the defendant had complied with the relevant provisions of law, the Secretary of State of the State of Utah issued his Certificate of Amendment to the articles of incorporation of the defendant, whereby its capital stock was fixed in the amount of \$1,500,000.00 divided into 15,000 shares, each of the par value of \$100.00. Of said amount \$1,110,000.00 was represented by 11,100 shares of common stock, and the remaining capitalization, to-wit, \$400,000.00 was divided into 4,000 shares of preferred stock. Said preferred stock was further subdivided into 750 shares of class 1 preferred stock possessing a total par value of \$75,000.00 and entitled to a preference over all other classes of stock of the company of 10% cumulative dividends, and 3,250 shares of class 2 preferred stock possessing a total par value of \$325,000.00 and entitled to a preference over the common stock of 6% cumulative dividends. This amendment contained no *express* provision making said preferred shares redeemable or callable. (R. 04, 26.)

6. On December 2, 1916, the defendant further amended its articles of incorporation in the manner required by law, and on the 5th day of December, 1916, the Secretary of State of the State of Utah issued his Certificate of Amendment whereby the capitalization of the company was fixed in the amount of \$2,000,000.00 divided into 20,000 shares each of \$100.00 par value. Of

said amount \$1,350,000.00 was represented by 13,500 shares of common stock, and the remaining capitalization, to-wit \$650,000.00, was divided into 6,500 shares of preferred stock. Said preferred stock was further subdivided into 750 shares of class 1 preferred stock of a total par value of \$75,000.00 and entitled to a preference over all other classes of stock of the company of 10% cumulative dividends, and 5,750 shares of class 2 preferred stock possessing a total par value of \$575,000.00 and entitled to a preference over the common stock of 6% cumulative dividends. This amendment contained no *express* provision making the preferred shares redeemable or callable. (R. 05, 26.)

7. On March 2, 1922, after due compliance with the relevant provisions of law by the defendant, the Secretary of State of the State of Utah issued his Certificate of Amendment to the articles of incorporation of defendant, which amendment declared:

“Class 1 preferred stock may be retired or redeemed by the Board of Directors at any time after the first day of January, 1923, at par plus accrued dividends, and such stock may again be issued and sold at par with preferred cumulative dividends in an amount to be fixed by the Board of not more than 6% per annum.”

This amendment, however, contained no *express* provision making class 2 preferred stock redeemable or callable. (R. 05. 06, 27.)

8. At some unascertainable time, but long prior to the commencement of this action, the Board of Directors of the defendant corporation redeemed and retired

all of the class 1 preferred stock, and at the time of the commencement of this action no class 1 preferred stock was issued and outstanding. (R. 06, 27.)

9. At the times and on the occasions plaintiffs and their predecessors in interest and ownership purchased and acquired the shares of class 2 preferred stock described in plaintiffs' complaint, the articles of incorporation of the defendant authorized the issuance by the defendant of class 2 preferred shares with preference as to dividends at the rate of 6% per annum, cumulative; and the articles of incorporation further provided that if said shares of class 2 preferred stock were outstanding upon the dissolution of defendant, they would have preference in connection with the distribution of the assets of the defendant, as set forth in Article XIII of the original articles of incorporation of the defendant. At the time of the original issuance by the defendant of said class 2 preferred shares, and until the adoption of the amendment to defendant's articles of incorporation hereinafter described in paragraph 10 hereof, the articles of incorporation of defendant, as amended, contained no *express* provisions for the retirement or redemption of said class 2 preferred shares. The denial by the defendant of allegations contained in Paragraph XI of plaintiffs' first cause of action, to the effect that the said class 2 preferred shares were issued by the defendant without reserving to it the right or privilege of retirement or redemption, constitutes a denial of legal conclusions of plaintiffs' pleader, which set forth his theory of the case. Further, the affirmative

allegation of the defendant in Paragraph 8 of its answer, to the effect that all of said shares of class 2 preferred stock were issued by defendant company subject to the right in the company, through action of its stockholders, to amend its articles of incorporation as provided by the statutes of the State of Utah so as to provide for the calling and redemption of said preferred stock, also constitutes a legal conclusion of the defendant, which in turn declares its theory of this case. The plaintiffs admit that there was no specific agreement or understanding made with them *personally* and *individually* by the defendant that said shares of stock acquired by them should remain permanent and unredeemable shares. The allegation of this import contained in Paragraph XI of plaintiffs' first cause of action is a conclusion based upon the status of the articles of incorporation of the defendant, and is not an attempt on the part of the plaintiffs to assert that independent of the articles of incorporation there was any particular personal agreement with them that the shares of class 2 preferred stock would remain permanent and unredeemable. The present plaintiffs did not acquire their shares of stock directly from the company, but from mesne owners. (R. 06, 07, 27, 28.)

10. A special meeting of the stockholders of the company was held at the office of the company in Salt Lake City, Utah, on the 10th day of November, 1947, at the hour of 5:15 o'clock P.M. That said meeting was called and noticed as required by law, for the purpose of considering amendments to the articles of incorpora-



tion of the company. At the time of said meeting there were issued and outstanding 11,961 shares of the capital stock of said company, of which amount 10,135 shares were common stock and 1,826 shares were class 2 preferred stock. Represented at said meeting, either in person or by proxy, were 9,823 shares of common stock and 1,809 shares of class 2 preferred stock. Of the total issued and outstanding common stock 312 shares were not represented at said meeting, and of the total outstanding class 2 preferred stock 17 shares were not represented at said meeting, by formal power of attorney or proxy. There was submitted for consideration by the stockholders of the company assembled and represented at said meeting, the following resolution:

“BE IT RESOLVED that the Articles of Incorporation of the Company be and they are hereby changed and amended so as to make the Preferred Stock of the Company subject to call for redemption, and redemption, at any time by the Board of Directors, at par plus dividends accrued to the date of redemption, by amending Article VIII of the Articles of Incorporation of this Company, as heretofore amended, so that said article VIII will read as follows:

#### ‘ARTICLE VIII.

‘The limit of the capital stock of this corporation shall be \$2,000,000.00, divided into 20,000 shares of the par value of \$100.00 each, of which 13,500 shares having an aggregate par value of \$1,350,000.00 shall be denominated Common Stock, and 6,500 shares having an aggregate par value of \$650,000.00 shall be denominated Preferred Stock; 750 shares of

said Preferred Stock having an aggregate par value of \$75,000.00 shall be designated Class One, and 5,750 shares of said Preferred Stock, having an aggregate par value of \$575,000.00 shall be designated as Class Two.

'The holders of Preferred Stock shall be entitled to receive, when and as declared, from the surplus or net profits of the corporation, yearly dividends at the rate of six per centum per annum, and no more, payable on dates to be fixed by resolution of the Board of Directors. The dividends on the Preferred Stock shall be cumulative, and shall be payable before any dividends on the Common Stock shall be paid or set apart; so that if in any year, dividends amounting to six per centum shall not have been paid thereon, the deficiency shall be payable before any dividends shall be paid or set apart for the Common Stock.

'Whenever all cumulative dividends on the Preferred Stock for all previous years shall have been declared and shall have become payable and accrue dividends for the current year, on the Preferred Stock shall have been declared, and the corporation shall have paid such declared cumulative dividends for all previous years and such accrued dividends upon the Preferred Stock for the current year, or a sufficient amount for the payment thereof has been set apart from the surplus or net profits, the Board of Directors may declare dividends upon the Common Stock, payable then and thereafter out of the remaining surplus or net profits.

'All Preferred Stock shall be subject to call for redemption, and redemption, at any time by the Board of Directors at par plus dividends

accrued to the date of redemption, in such amounts as from time to time the Board of Directors may determine, by paying to each holder of said Preferred Stock so called for redemption, or by depositing to the order of such holder at the office of the Company or at any bank in Salt Lake City, Utah, a sum equal to the par value of the Preferred Stock of such holder called for redemption, together with accumulated and unpaid dividends thereon to date of redemption. If only part of the issued and outstanding Preferred Stock is called for redemption, the same shall be redeemed and paid pro rata among all holders of Preferred Stock outstanding.' "

Upon motion duly made and seconded, the adoption of said resolution was put to a vote, and thereafter the Chairman of said meeting declared that the same had been adopted by an affirmative vote of 9,823 shares of stock represented at said meeting as against 1,809 shares which were voted in opposition thereto. Said 9,823 shares voting in favor of said resolution were all common shares represented at said meeting. No class 2 preferred shares were voted in favor of said resolution. The negative vote of 1,809 shares was composed solely of class 2 preferred shares, which were owned as follows:

Ethelbell M. Harmon .....	900 shares
Hichard H. Mumper .....	17 shares
Edwin A. Meserve .....	58 shares
Shirley E. Meserve .....	25 shares
William J. Cowan .....	50 shares
Lesley D. W. Riter.....	50 shares
Tracy-Collins Trust Co. ....	9 shares
Beneficial Life Insurance Co. ....	100 shares

Sarah Daft Home .....	275 shares
A. F. Tilton .....	325 shares

Total .....	1,809 shares
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The 17 shares of class 2 preferred stock not represented at said meeting, either in person or by formal proxy, were owned as follows:

Edna Dayton .....	8 shares
Damaris A. Beeman .....	9 shares

At said meeting the said Dayton and the said Beeman, both plaintiffs herein, were in truth and in fact represented by their attorney and agent, Franklin Riter, Esq., who with permission of the Chairman of said meeting, read into the records thereof a protest of said Dayton and said Beeman against the adoption of said resolution. Said Dayton and said Beeman have never consented or approved the adoption of said resolution, and have at all times dissented therefrom. (R. 07, 08, 09, 28.)

11. Acting under the authority and direction of more than the majority, to-wit more than 2/3 of the outstanding shares of stock of the defendant, the defendant by and through the President and Secretary of its Board of Directors filed with the Clerk of Salt Lake County, Utah, on the 12th day of November, 1947, in conformity with the laws of the State of Utah, a certificate setting forth the amendment to the articles of incorporation of the defendant adopted in the form of the resolution set forth in Paragraph 10, supra. On the 13th day of November, 1947, a certified copy of said amendment was filed in the office of the Secretary of State of the State of Utah, and on said last mentioned

date the Secretary of State issued his Certificate evidencing such amendment. The said amendment authorizes the Board of Directors of the defendant to call for redemption and retirement the class 2 preferred stock outstanding and owned by plaintiffs in the several amounts hereinabove set forth in Paragraph 1 hereof. The denials contained in Paragraph 10 of defendant's answer, denying that the said last mentioned amendment to the articles of incorporation is null and void and without legal effect, and the denial by defendant of plaintiffs' allegation that the adoption of said amendment by a majority of the stockholders of the defendant was not authorized by law, are denials of legal conclusions set forth in plaintiffs' complaint. Likewise, defendant's assertion contained in Paragraph 10 of its answer, that said amendment was and is authorized by the statutes of Utah, is also the allegation of a legal conclusion. The further denials of defendant contained in Paragraph 10 of its answer, of plaintiffs' assertion that Sections 338 and 339, Revised Statutes of Utah of 1898, as amended, do not authorize the amendment adopted by defendant's stockholders on November 10, 1947, without the consent of the owners of all of the outstanding class 2 preferred stock; and the further denial by defendant of plaintiffs' contention that said sections are unconstitutional or null and void as to plaintiffs, in that if said statutes are construed to authorize said amendment without the plaintiffs' consent, it impairs the contract rights of plaintiffs in derogation of federal and state constitutional provisions, are denials of plaintiffs' legal conclusions, which

set forth their theory of their case against defendant. The denial of defendant of plaintiffs' claim of right to own and retain their several shares of class 2 preferred stock free and exempt from the privilege of redemption by defendant, as a vested contract or property right, is also a denial by defendant of a conclusion contained in plaintiffs' complaint. The allegations of plaintiffs that they or their predecessors in ownership and interest acquired said shares of stock upon the agreement or covenant of the company that said shares were not subject to redemption or retirement, is an allegation denied by defendant, but in view of the plaintiffs' position hereinabove set forth with respect to the nature of this agreement there is no issue of fact here involved. (R. 09, 10, 28, 29.)

12. Under the authority of said amendment adopted on November 10, 1947, the officers and directors of defendant have expressed and announced their intention to call for redemption and retirement all of the class 2 preferred stock of defendant, at par plus accrued dividends to date of redemption, and defendant will assert and claim the right to call for redemption and to redeem the shares of stock owned by plaintiffs, and it will after such call for redemption refuse to recognize the owners and holders of class 2 preferred stock as stockholders of defendant. (R. 11, 30.)

#### RELEVANT CONSTITUTIONAL PROVISION

At the time the defendant was organized, on April 4, 1898, there was and there still is in effect the follow-

ing provision of the Constitution of the State of Utah, to-wit:

1. *Constitution of the State of Utah.*

(a) "Corporations may be formed under general laws, but shall not be created by special acts. All laws relating to corporations may be altered, amended or repealed by the Legislature, and all corporations doing business in this State, may, as to such business, be regulated, limited or restrained by law." (Article XII, Section 1.)

STATUTORY REFERENCES

1. There was at the time defendant was incorporated in full force and effect Section 338, Title 11, Chapter 1, Revised Statutes of Utah, 1898, effective January 1, 1898, reading as follows, to-wit:

"338. The articles of incorporation of any corporation now existing or that hereafter may be organized under the laws of this state may be amended in any respect conformable to the provisions of this chapter by a vote representing at least two-thirds of the outstanding capital stock thereof at a stockholders' meeting called for that purpose, as hereinafter prescribed; provided, that the original purpose of the corporation shall not be altered, nor shall the capital stock be diminished to an amount less than fifty per cent in excess of the indebtedness of the corporation; and provided further, that the liability of the holder of full-paid capital stock for assessments or for the indebtedness of the corporation shall not be changed without the consent of all the stockholders."

2. Section 338, Revised Statutes of Utah, 1898, remained a part of the Statutes of the State of Utah,

unchanged, until it was amended by Chapter 94, Session Laws of Utah, 1903, to read as follows:

“338. The articles of incorporation of any corporation now existing or that hereafter may be organized under the laws of this State may be amended in any respect conformable to the laws of this State by a vote representing at least two-thirds of the outstanding capital stock thereof at a stockholders' meeting called for that purpose as hereinafter prescribed. Provided, that the original purpose of the corporation shall not be altered, nor shall the capital stock be diminished to an amount less than fifty per cent in excess of the indebtedness of the corporation; and provided, further, that the personal or individual liability of the holder of full-paid capital stock for assessments or for the indebtedness or obligations of the corporation shall not be changed without the consent of all of the stockholders.”

3. Section 338, Revised Statutes of Utah, 1898, as amended by Chapter 94, Session Laws of Utah, 1903, and as amended by an act approved March 3, 1905, was further amended by Chapter 131, Session Laws of Utah, 1905, to read as follows:

“338. The articles of incorporation of any corporation now existing or that hereafter may be organized under the laws of this State may be amended in any respect conformable to laws of this State by a vote representing at least a majority in amount of the outstanding capital stock thereof at a stockholders' meeting called for that purpose, as prescribed in Section 339 of the Revised Statutes of Utah, 1898, as amended by chapter 94, laws of Utah, 1903; provided, that if all the stockholders vote in favor of such amend-



ment at any meeting of the stockholders, the notice required by Section 339 aforesaid need not be given; and provided further that the original purpose of the corporation shall not be altered or changed without the approval and consent of all the outstanding stock; provided further, that the adding to the purposes or object, or extending the power and business of the corporation, shall not be deemed a change of the original purpose of the corporation; provided, further, that the capital stock of the corporation shall not be diminished to an amount less than fifty per cent in excess of the indebtedness of the corporation; and provided further, that the personal or individual liability of the holder of full-paid capital stock for assessments or for the indebtedness or obligation of the corporation shall not be changed without the consent of all the stockholders."

4. Section 338 was carried into the Compiled Laws of Utah, 1917, as Section 886 therein and continued in force unchanged until amended by Chapter 16, Session Laws of 1919 in matters not relevant here, and by Chapter 22, Session Laws of 1921 to read as follows:

"886. The articles of incorporation of any corporation now existing or that hereafter may be organized under the laws of this state may be amended in any respect conformable to the laws of this state by a vote representing at least a majority in amount of the outstanding stock thereof at a stockholders' meeting called for that purpose as prescribed in Section 887; provided, that if all the stockholders vote in favor of such amendment at any meeting of the stockholders, the notice required by Section 887 aforesaid need not be given; and provided further, that the original purpose of the corporation shall not be al-

tered or changed without the approval and consent of all the outstanding stock; provided further, that the adding to the purposes or object or extending the power and business of the corporation, shall not be deemed a change of the original purpose of the corporation; provided further, that the capital stock of the corporation shall not be diminished to an amount less than fifty per cent in excess of the indebtedness of the corporation; and, provided further, that the personal or individual liability of the holder of full-paid stock for assessments or for the indebtedness or obligation of the corporation shall not be changed without the consent of all the stockholders."

5. Section 886, Compiled Laws of Utah, 1917, as amended as aforesaid by Session Laws of Utah 1919 and Session Laws of Utah 1921, has been carried further into Utah Code Annotated 1943 and is now in full force and effect as Section 18-2-44, Utah Code Annotated 1943, which reads as follows:

"The articles of incorporation of any corporation now existing or that hereafter may be organized under the laws of this state may be amended in any respect conformable to the laws of this state in such manner and by the vote of such proportion of all or any class or classes of stock as the articles of incorporation may provide; and in case the articles of incorporation do not so provide, by a vote representing at least a majority in amount of the outstanding stock thereof entitled to vote at a stockholders' meeting called for that purpose as prescribed in Section 18-2-45; provided, that, if all the stockholders entitled to vote vote in favor of such amendment at any meeting of the stockholders, the

notice required by section 18-2-45 need not be given; and provided further, that the original purpose of the corporation shall not be altered or changed without the approval and consent of all the outstanding stock, but the adding to the purposes or object or extending the power and business of the corporation shall not be deemed a change of the original purpose of the corporation; provided further, that no amendment shall be made which shall have the effect of reducing or of authorizing the reduction of the capital, subscribed or paid in, of the corporation to an amount less than fifty per cent in excess of the indebtedness of the corporation; and provided further, that the personal or individual liability of the holder of full-paid stock for assessments or for the indebtedness or obligations of the corporation shall not be changed without the consent of all the stockholders."

## ARGUMENT

### I.

THE RESERVED POWER OF AMENDMENT CONTAINED IN THE CONSTITUTION OF THE STATE OF UTAH AND IMPLEMENTED BY SEC. 338, TITLE 11, CHAP. 1, R. S. OF UTAH 1898 (OPERATIVE ON DATE OF INCORPORATION OF DEFENDANT) AND SEC. 18-2-44, UTAH CODE 1943 (OPERATIVE ON DATE OF THE QUESTIONED AMENDMENT TO DEFENDANT'S ARTICLES OF INCORPORATION) DID NOT AUTHORIZE THE AMENDMENT TO DEFENDANT'S ARTICLES OF INCORPORATION CONVERTING NON-CALLABLE AND NON-REDEEMABLE PRE-

PERRED STOCK TO CALLABLE AND REDEEM-  
ABLE PREFERRED STOCK.

1. The power reserved by the State of Utah in its constitution and statutes to amend, alter or repeal all laws relating to corporations was the result of the Dartmouth College case, and such reservation was and is intended to eliminate the results of said decision.
2. The reservation of power to amend, alter or repeal corporation laws protect the relationship between the state and the corporation and is to be exercised in matters of public concern and welfare. The reservation of power when properly construed does not appertain to the relationship between the corporation and its stockholders or between the stockholders inter se.

1. The power reserved by the State of Utah in its constitution and statutes to amend, alter or repeal all laws relating to corporations was the result of the Dartmouth College case, and such reservation was and is intended to eliminate the results of said decision.

The proper orientation of the issues in this case can only be made by due consideration to the holding of the United States Supreme Court in *Dartmouth College vs. Woodward*, 4 Wheat. (U.S.) 518, 638, 643; 4 Law Ed. 629. The following quotation from Chief Justice Marshall's opinion is pertinent:

“The benefit to the public is considered as an ample compensation for the faculty it confers, and the corporation is created. If the advantages to the public constitute a full compensation for

the faculty it gives, there can be no reason for exacting a further compensation by claiming a right to exercise over this artificial being, a power which changes its nature and touches the fund, for the security and application of which it was created. There can be no reason for implying in a charter given for a valuable consideration, a power which is not only expressed, but is in direct contradiction to its express stipulations. From the fact, then, that a charter of incorporation has been granted, nothing can be inferred which changes the character of the institution, or transfers to the government any new power over it. The character of civil institutions does not grow out of their incorporation, but out of the manner in which they are formed, and the objects for which they are created. The right to change them is not founded on their being incorporated, but on their being the instruments of government, created for its purposes. . . . This is plainly a contract to which the donors, the trustees and the crown (to whose rights and obligations New Hampshire succeeds) were the original parties. It is a contract made on a valuable consideration. It is a contract for the security and disposition of property. It is a contract, on the faith of which, real and personal estate has been conveyed to the corporation. It is, then, a contract within the letter of the constitution, and within its spirit also."

This decision has been the subject of discussion and comment by Courts and text writers through the years. Many diverse opinions were held at one time or another concerning its operative effect. The final word on the subject, however, is expressed by Fletcher as follows:

"The true view is that the power to alter,

amend, or repeal charters is reserved by the state 'solely' for the purpose of avoiding the effect of the decision in the Dartmouth College Case; that the charter of a corporation is a contract between the state and the corporation within the constitutional prohibition against laws impairing the obligation of contracts, and that the purpose of the reservation is to enable the state to impose such restraints upon corporations as the legislature may deem advisable for the protection of the public. Such power is not reserved in any sense for the benefit of the corporation, *or of a majority of the stockholders, upon any idea that the legislature can alter the contract between the corporation and its stockholders, nor for the purpose of enabling it to do so.* If this view is sound — and that it is so seems clear — the power of the majority of the stockholders to bind a dissenting minority by accepting an amendment of the charter does not depend at all upon whether the state has reserved the power to alter or amend the charter, but depends essentially upon the question whether the change is of such character that it may be deemed so far in furtherance of the original undertaking, and incidental to it, as to be fairly within the power of the corporation to bind its individual members by its corporate assent, or whether it is such a departure from the original purpose that no member should be deemed to have authorized the corporation to assent to it for him." (Emphasis supplied.) (13 Fletcher Cyclopaedia Corporation—Permanent Edition—Section 5776, Pages 85-87.) (Cf: 3 Clark & Marshall, Private Corporations, Section 631f.)

The above stated conclusion of Fletcher is fully supported by authorities cited by him.

The following comments may also be appropriately considered:

"It has been said that the charter of a private corporation operates on a three-fold relationship to establish a contract between the State and the corporation, between the corporation and its stockholders, and between the stockholders and the State, and that it also constitutes a contract between the stockholders inter se." (12 C. J., Section 648, pp. 1023-24.)

"As the courts have not agreed as to what amendments are or are not so material or fundamental that they cannot be assented to by a majority of the stockholders or members so as to bind the minority, there is as to some amendments a direct conflict in the decisions. Among the amendments which have been held to be so fundamental as to require unanimous assent are: Amendments which are not in relation to matters which concern the public, but which change the rights of the stockholders or members inter se, as by changing the method of voting at corporate meetings; amendments authorizing a corporation to engage in a fundamentally different business or enterprise from that for which it was created; authorizing a change from a mutual insurance company to a joint-stock company, thus impairing the rights of the policyholders and members; converting a gas and electric lighting company into a street railway company; authorizing a corporation organized to manufacture preserves, syrups, and the like, to engage in the sale of liquor; authorizing a railroad, turnpike, or toll road company to materially change the termini, location, or route of its road, or to extend its road to such an extent as to materially change the original enterprise; conferring upon a rail-

road company the privilege of selling its road; authorizing a lease of corporate property to another corporation for nine hundred and ninety-nine years; authorizing a subdivision of the corporation; authorizing corporations to consolidate; making non-assessable full-paid stock assessable; increasing the capital stock; reducing the minimum number of subscribed shares, thus rendering a shareholder liable, who otherwise would not be; or authorizing the creation of preferred stock and compelling the stockholders to surrender their common stock and take the preferred stock in lieu thereof." (14 C. J., Section 194, pp. 189-190.)

"It is not important to inquire into the original reason for the reservation of this power to amend, but it has been judicially suggested that it was due to the desire on the part of individual states to escape the effect of the decision in the *Dartmouth College Case*. Indeed, Mr. Justice Story in his separate opinion suggested this as a method by which the states might avoid the effect of such a doctrine. Even before the *Dartmouth College case*, the supreme court of Massachusetts intimated such a reservation would save to the state its power to control corporations. And the New Jersey court said that 'the object and purpose of these provisions are so plain, and so plainly expressed in the words, that it seems strange that any doubt should be raised concerning it. It was a reservation to the state, for the benefit of the public, to be exercised by the state only. The state was making what had been decided to be a contract, and it reserved the power of change, by altering, modifying or repealing the contract. Neither the words nor the circumstances nor apparent objects for which this provision was made, can, by any fair construction,



extend it to giving power to one part of the corporators as against the other, which they did not have before. It was to avoid the rule in the *Dartmouth College* case.' This principle of the reserved power to amend proceeds on the theory that such reservation is incorporated in the charter, and that it qualifies the grant, and hence any subsequent exercise of such reserved power cannot be regarded as an act within the prohibition of the constitution. The right to amend under such reserved power is unquestioned." (Thompson on Corporations, Third Edition, Section 431, pp. 545-546.)

"The exercise of the power of amendment under the right reserved either by statute or constitution cannot be arbitrary or unlimited. This reserved power must be exercised within the scope of the original charter. Under it the nature and purposes of the corporation cannot be changed; they can only be amended. It is conceded that under this reserved power the state may tender what in its opinion is a proper amendment, and require its acceptance, or compel a cessation of business. Thus, it was said by the United States Supreme Court that 'such a reservation, it is held, will not warrant the legislature in passing laws to change the control of an institution from one religious sect to another, or to divert the fund of the donors to any new use inconsistent with the intent and purpose of the charter, or compel subscribers to the stock, whose subscriptions are conditional, to waive any of the conditions of the contract.' In a much later case the court again said: 'The effect of such a provision, subject to which a charter is accepted, is, at least, to reserve to the legislature the power to make any alteration or amendment of a charter subject to it, which will not defeat or substantially im-

pair the object of the grant, and which the legislature may deem necessary to carry into effect the purposes of the grant, or to protect the rights of the public or of the corporation, its stockholders or creditors, or to promote the due administration of its affairs.' It has been said that under this power the legislature can do no more than to waive the public rights; that it cannot divert or impair the rights of shareholders as between themselves, as it is upon the faith of stipulations contained in the charter that the shareholders become subscribers and make themselves members of the corporation. \* \* \* ” (Thompson on Corporations, Third Edition, Section 438, pp. 555-556.)

“And it is equally clear that, if the State has not reserved the power to alter, amend, or repeal the charter of the corporation, or if, although there is such a reservation, it is to be construed as is held by most courts, as intended merely for the protection of the public, and not for the purpose of enabling the legislature to change the contract between the corporation and its stockholders, the legislature has no power to authorize a majority of the stockholders to bind the minority by accepting such amendment; for this would be to impair the obligation of the contract between the corporation and the dissenting stockholders, by forcing them into a different contract, and therefore would be within the constitutional prohibition against laws impairing the obligation of contracts.” (3 Clark & Marshall, Private Corporations, Section 631f.)

“ \* \* \* Any attempt to use the power of amendment for the purpose of authorizing a majority of the stockholders to force upon the minority a material change in the enterprise is contrary to law, and against the spirit of justice. Under

such reserved power the legislature has only that right to amend the charter which it would have had in case the *Dartmouth College* case had decided that the federal constitution did not apply to corporate charters. \* \* \* The power to make given to the legislature. The legislature may repeal the charter, but cannot force any stockholder into a contract against his will. \* \* \* The best view taken of this reserved power of the State is that under it a fundamental amendment of the charter does not authorize a majority of the stockholders to accept the amendment and proceed, but that the unanimous consent of the a new contract for the stockholders is not thereby stockholders is necessary." (Cook on Corporations, Fifth Edition, Section 501.)

It is submitted that the doctrine of the *Dartmouth College* case, as interpreted above, definitely limits the operative effect of Section 1, Article XII of the Constitution of the State of Utah, which declares that "All laws relating to corporations may be *altered*, amended, or *repealed* by the legislature \* \* \*," of Sec. 338, RS 1898 and of Sec. 18-2-44, U. C. 1943.

2. **The reservation of power to amend, alter or repeal corporation laws protect the relationship between the state and the corporation and is to be exercised in matters of public concern and welfare. The reservation of power when properly construed does not appertain to the relationship between the corporation and its stockholders or between the stockholders inter se.**

There is a certain aspect of the decision of the Supreme Court of Utah in *Garey, et al, vs. St. Joe Mining Company*, 32 Ut., 497, 91 Pac. 369, 12 LRA (N.S.) 554, which should be considered in interpreting the Consti-

tutional provision and statutes involved in this action.

Both Salt Lake Hardware Company and St. Joe Mining Company were organized under the statutory provisions of similar legal effect. Salt Lake Hardware Company was organized on April 4, 1898; St. Joe Mining Company in 1897. At the time of the organization of the St. Joe Mining Company, Laws of Utah, 1896 at p. 30 (Sec. 2273) provided in pertinent part:

“The capital stock of any corporation \* \* \* may be increased \* \* \* or such capital stock may be diminished. The name of such corporation may be altered, the number of its directors, or officers be changed \* \* \* *the articles of agreement or incorporation may be otherwise changed or amended*; provided such amendment does not alter the original purpose of the corporation.”

The foregoing provision was redrafted and appeared in R. S. Utah 1898 as Sec. 338 as above set forth in paragraph 1 of Statutory References, supra.

The Utah law at the time of the incorporation of both companies authorized the articles of incorporation to be amended “in any respect” (Salt Lake Hardware Co.) or to “be otherwise changed or amended” (St. Joe Mining Co.).

The *St. Joe* case held that the conversion of non-assessable shares into assessable shares was not authorized by the statute, and if it were construed as to authorize such action, the statute would impair the obligations of contract (Utah Constitution, Art I, Sec. 18; Federal Constitution, Art. I, Sec. 10) or would deprive the stockholder of his property without due

process of law (Utah Constitution, Art. I, Sec. 7; Federal Constitution, 14th Amendment) and therefore would be void. The following quotation from the St. Joe decision is relevant:

“From the texts and the cases it will be seen that under the reservation the state is not only unauthorized to alter or amend charters of existing corporations in such a way as will change the fundamental character of the corporation, impair the object of the grant, or rights vested thereunder, but it is also unauthorized to alter or amend them in such a way as will impair the contractual relations or rights of the stockholders among themselves, or between the corporation and its stockholders; and it will also be seen that under the reserved power the Legislature has only the right to amend the charter, or laws with respect thereto, which it would have had in the event it had been decided in the Dartmouth College case that the federal Constitution did not apply to corporate charters. The Dartmouth College case did not call in question nor involve any right or relation of the corporators among themselves. It involved only the relation of the corporation and the state. Without the reservation it was held that even such relation cannot be changed without doing violence to the federal Constitution. Because of the reserved power the state may now amend or alter the charter, so far as effecting the contract with itself, and so long as it does not change the fundamental character of the corporation or impair any vested rights acquired thereunder. But, as stated by the authorities, the right is reserved for the benefit of the state and of the public and for public purposes. The power can only be exercised to the extent that the state is interested.

It can alter or modify any right, privilege, or immunity granted by it. It cannot, however, reach out and impair the obligations of contracts existing between the corporation and its members, or among the corporators themselves, any more than it can impair the obligations of contracts existing between other individuals. Undoubtedly it may take away altogether the franchise and privileges granted under it. The exercise of such powers pertain directly to its contract, and was expressly reserved to the state, and with reference to which every stockholder subscribed for or purchased his stock. So under the reserved power, the Legislature may make such reasonable amendments or alterations as it may deem necessary to carry into effect the purposes of the grant, or to protect the rights of the public, or of the incorporation and its stockholders, or to promote the due administration of its affairs, when such amendments or alterations will not defeat or substantially impair the object of the grant or any vested rights. Independent of the reservation there are many things which the state may do in the exercise of its police powers towards regulating and restricting corporate powers and functions. When reasonably exercised, such legislative enactments do not fall within the prohibition of the federal Constitution."

The line of reasoning of the *St. Joe* case finds support and elaboration in a most respectable and impressive line of authorities:

"*Norris vs. American Pub. Utilities Co.* (1923) 14 Del., Ch. 136, 122 A. 696 was a suit to declare void an amendment to defendant's certificate of incorporation, by the terms of which it was provided (1) that two new classes of preferred

stock be created, having preference over the original preferred stock; (2) that accumulated dividends accrued and unpaid on the original preferred stock be canceled; (3) that the original redemption figure of \$105 on the preferred stock be reduced to \$100; (4) that the preferred stock's right be taken away. In respect of the first change it was held that since the Delaware Corporation Law, under which defendant was organized, authorized changes in the corporate charter affecting the preferences granted to preferred stock, the creation of two new classes of preferred stock superior to the original preferred stock was authorized, since such change merely affected the preference rights of the original preferred stock. The third change was upheld under another section of the Corporation Law providing: 'Any or all classes of preferred stock \* \* \* may be made subject to redemption at such time or times, and at such price, not less than par, as may be expressed in the certificate of incorporation, or any amendment thereof;' and the fourth alteration was permitted under the general clause of the statute permitting a corporation to make 'any other change or alteration in its charter of incorporation that might be desired.' However, it was held in respect of the cancellation of the unpaid accrued dividends that they represented vested rights of the preferred stockholders which could not be impaired under either the portions of the statute referring to preference rights or under the general clause."

*Yoakam vs. Providence Biltmore Hotel Company*, (1929) D.C. 34 Fed. (2d) 533: This case holds that under a statute providing that any corporation may amend its charter "by making any other change or alteration in

its charter or incorporation that may be desired," that the corporation was not authorized to amend its charter in such manner as would cancel the obligation undertaken by the corporation under its original Certificate of Incorporation, to set aside \$20,000.00 annually as a sinking fund for the purchase or redemption of preferred stock.

*Pronic vs. Spirits Distributing Company*, (1899) 58 N.J. Eq. 97, 42 Atlantic 586: The statute under which the defendant was organized authorized it "to amend its original certificate with the assent of a majority in interest of the stockholders." The defendant attempted to amend its certificate by reducing the dividend rate on the first preferred stock from 7% to 6%, and from 6% to 2% on the second preferred stock. The Court held such amendments invalid. The Court said:

"In my judgment these general powers of amendment of the certificate which originally fixed the relation between the stockholders interest do not confer the power of altering the previous contract of the company itself with the stockholder as to the rate of dividend which was granted by a stock certificate or contract of the company, which was required by the statute to express this rate of dividend, and which reserved no power of the company to change. Such alteration would impair the obligation of the contract created by the stock certificate issued under the company charter."

*Keller vs. Wilson & Company*, (1936) Del. 190 Atl. 115; (*Delaware Chancery Court*) 180 Atl. 584. Section 26 of the General Corporation Law of Delaware author-



ized amendments to corporate charters, increasing or decreasing the authorized capital stock or changing the common par value, designation, preferences or relative participating option or other special rights of the shares. The Court held that this statute was prospective in operation, and that any amendment which destroyed the rights of holders of cumulative preferred stock to accrued and unpaid dividends was not within its authorization.

*Consolidated Film Industries vs. Johnson*, (1937) Del. 197 Atl. 489: The defendant adopted an amendment to its certificate of incorporation which provided that the existing preferred stock, on which there were dividends accrued and unpaid, should "become and be, and shall be surrendered and exchanged for" other preferred stock entitled to a lower dividend rate. The Court held that the corporation had no power under the statute mentioned in the Keller case *supra* to compel the plaintiff, who held some of the original preferred stock to forfeit his rights to accrued dividends.

*Breslav vs. New York & Queens Electric Light & Power Company*, (1936) 249 App. Div. 181, 291 N.Y.S. 932, affirmed without opinion (1937) 273 N.Y. 593, 7 N.E. (2d) 708: A New York statute authorized corporations "to classify or re-classify any shares, either with or without par value." The corporation, by an amendment to its charter, provided that certain non-callable preferred stock would be callable at a given figure. The Court said:

“However, this reserved power is not unlimited, and its exercise is subject to the restrictions and restraints imposed by other provisions of the State and Federal Constitutions. Due process of law must be observed, and vested property rights and the obligation of contracts must not be destroyed or impaired. *Coombes v. Getz*, 285 U. S. 434, 52 S. Ct. 435, 76 L. Ed. 866; *Phillips Petroleum Co. v. Jenkins*, 297 U. S. 629, 56 S. Ct. 611, 80 L. Ed. 943. While limitations on the amending power cannot be reduced to fixed rules, the following cases illustrate what amendments constitute an improper exercise of the reserved power \* \* \*

“If a stockholder may not be deprived of his right to vote for all the directors [*Lord v. Equitable Life Assurance Society of the United States*, 194 N. Y. 212, 237, 87 N. E. 443, 22 L. R. A. (NS) 420] or his right to payment on the named redemption date [*Sutton v. Globe Knitting Works*, 276 Mich. 200, 267 N. W. 815, 105 A.L.R. 1447], or may not be denied his right to a voice in the management of a corporation [*Page v. American and British Manufacturing Co.*, 129 App. Div. 346, 113 N.Y.S. 734], or to the continuance of a sinking fund set up for the payment of his stock [*Yoakam v. Providence Biltmore Hotel Co. (DC)*, 34 Fed. (2d) 533, 546] and if a majority may not make his non-assessable stock assessable [*Garey v. St. Joe Mining Co.*, 32 Utah 497, 91 Pac. 369, 12 LRA (NS) 554]—because to do any of these acts would result in impairing his contract or taking his property without due process of law, or both — surely his right to remain a stockholder as long as the company exists is entitled to equal protection and for the same reasons. Obviously the proposed amendment is not designed to protect any rights of the public, nor does it

concern the policy of the state, nor does it regulate or control the internal management of the corporation as far as it has relation with the state."

*A. C. Frost & Company vs. Coeur d'Alene Mines Corporation*, (1939) Idaho 92 Pac. (2d) 1057: In this case the defendant, by amendment to its articles of incorporation, attempted to convert non-assessable stock to assessable stock. Reliance was placed upon the act of the legislature which authorized corporations to change non-assessable to assessable stock, although adopted after date of incorporation of the company. The Court construed the statute as not including power to effect such amendment, and cited with approval the *St. Joe* case from Utah.

*Johnson vs. Tribune-Herald Company*, 155 Ga. 204, 116 S.E. 810 involved an amendment to the charter of a corporation effected by a majority of the stockholders, in the face of opposition by minority stockholders, whereby it was proposed to convert non-callable preferred stock into callable and redeemable shares. The Court in declaring such amendment invalid said:

"It is now well settled in this state that when proposed amendments to a charter are fundamental, radical, or vital, the unanimous consent of all stockholders to their acceptance is necessary. (p. 811) \* \* \* The next change proposed is that the corporation shall have the right to retire any and all of the preferred stock, at such price as the corporation may agree upon with the owner thereof, at such time as it may deem proper. \* \* \* There is no provision in the char-

ter for the retirement of preferred stock. The proposed amendment provides for the retirement of preferred stock. This is a radical change, and requires the unanimous consent of the stockholders to become effective."

*Coombs v. Getz*, 285 U.S. 434, 52 S. Ct. 435, 76 L. Ed. 866:

"The authority of the state under the co-called reserve power is wide; but it is not unlimited. The corporate charter may be repealed or amended, and, within limits, not now necessary to define, the interrelations of the state, corporation and stockholders may be changed; but neither vested property rights nor the obligation of contracts with third persons may be destroyed or impaired \* \* \*."

*Midland Co-op. Wholesale v. Range Co-op. Oil Assn.*, 200 Minn. 538, 274 N.W. 624, 111 A.L.R. 1521:

"The articles of incorporation are the charter of a corporation and, subject to the constitution and laws of the state, its fundamental and organic law. \* \* \* It is a contract between the state and the corporation and among the incorporators inter se. \* \* \* It evidences the contract by which a stockholder binds himself. It measures and determines the nature and extent of the powers of the corporation, and defines and limits the field of corporate activities and the rights, obligations and liabilities of the stockholders. \* \* \* The charter cannot be amended without the consent and acquiescence of all the stockholders unless the power of amendment is reserved. The power to amend may be reserved by the constitution, statutes or articles of incorporation. The reserved power to amend must be exercised within the limits of the reservation \* \* \*. If the

reservation is general and not limited in terms, the reserved power of amendment does not permit a change so fundamental as to change the nature and purposes of the corporation \* \* \*."

*Strout v. Cross A and I Lumber Co.*, 283 N. Y. 406, 28 N.E. (2d) 890, 133 A.L.R. 646:

"Preferred stock issued by a stock corporation may grant to the stockholder a variety of rights depending largely upon the financial requirements of the corporation at the time the stock is issued. Whatever preferential rights and privileges may thus be granted to a stockholder, the law regards them as contractual. 'The certificate of stock is the muniment of the shareholder's title, and evidence of his right. It expresses the contract between the corporation and his co-stockholders and himself; and that contract cannot unwillingly be taken away from him or changed' \* \* \*."

*Fidelity Building and Loan Assn. v. Thompson*, 51 S.W. (2d) 578, 599:

"The reserved right in the state to 'alter, reform or amend' charters does not give the state the right to destroy or impair the rights of shareholders to their interest in the property of the corporation. If the state can destroy or impair the property rights of non-borrowing shareholders in the instant case by requiring them to suffer all losses when their position was equal with borrowing shareholders under the contract by which they became shareholders, then the state in any instance, and as to any corporation, can impair and destroy the rights of shareholders in the property thereof by legislation enacted after the contract is made."

*Sutton v. Globe Knitting Works*, 276 Mich. 200, 267 N.W. 815, 105 A.L.R. 1447, 1451:

“\* \* \* it seems clear that the redemption right of plaintiff as a preferred stockholder is something more and different in character than an ordinary incidental right of a stockholder, such as voting for the election of a director, and that his right is contractual in nature. The contract right was presumably a condition precedent to plaintiff's determination to purchase preferred stock in the defendant company. The redemption provision was a definite undertaking on the part of the defendant corporation to redeem at a given time and on given terms the stock plaintiff agreed to purchase. Assuming, as we fairly may, that in the absence of the redemption provision plaintiff would not have purchased his stock, or that defendant's undertaking to redeem was an inducing cause in consequence of which plaintiff did purchase, the provision for redemption was something more than a mere incident to corporate relationship; it was a definite contractual undertaking, the proposal for which antedated and consummation of which coincided with the purchase of the stock by plaintiff; who prior to that time was not identified with the corporation. This being true, appellee's contention above noted is not tenable. While it is quoted from a case wherein the plaintiff was a creditor of, and not a stockholder in, the defendant corporation, we think the following statement of the Supreme Court of the United States is applicable to the instant case: [Quotation from *Coombs v. Getz*, *supra*].”

*Vanden Bosch v. Michigan Trust Co.*, 35 Fed. (2d) 643, 645:

“We think this overlooks the true effect of the existing promise to redeem in 1925. This promise was authorized by statute, it was relied upon by the investor, and we see no reason why it is not essentially a contract beyond the power of the corporation to change materially without the consent of the investor. It follows that the statutory provisions for extension and the proceedings here taken must be regarded as subject to the performance of the duty created by this promise. The power of the corporation to amend its articles or its by-laws cannot extend to making a change which would amount to a repudiation of a contract which is distinct from, and in addition to all ordinary matters of internal management, regulation and control.”

The phrase “may be amended in any respect,” contained in both the 1898 statute and the 1943 Code provision, does not confer unlimited and unrestricted power upon the stockholders of a corporation. It is first limited by the specific prohibitions or limitations prescribed in the statutes themselves. (None of which are pertinent in this litigation.) The phrase is further and most cogently limited by the historical events which produced the constitutional reservation of power to amend, alter or repeal corporation laws and, also, by the underlying purpose of such reservation and its implementing legislation. Without a specific directive to the effect that such power may be exercised to alter or change the relationship between a corporation and its stockholders and between the stockholders inter se, the power to “amend in any respect” should not be construed to include the power to impair or destroy a stockholder’s

rights of property in his shares. If it be accepted that the statutory declaration operative at time of organization of the defendant authorizing the defendant to amend its articles "in any respect" became part of the articles in the same manner as if it were written therein, it will be binding upon the plaintiffs only insofar as the court may define the true substance and meaning of the phrase "may be amended in any respect." If the court refuses to adopt an interpretation granting majority stockholders unlimited power of amendment (subject only to statutory restrictions), then such construction of the statute is carried into the articles of incorporation of defendant.

The right plaintiffs acquired in the purchase or acquisition of defendant's second preferred stock to own and hold the same free and clear of the privilege of redemption by defendant was and is a most valuable property right. The preference granted was not only as to a guaranteed 6% dividend, but also included preference on liquidation of the defendant. Plaintiffs' shares, therefore, possess qualities which are ordinarily not only those of common shares—that of permanency of investment—but also qualities usually conferred upon preferred shares—that of priority upon liquidation, and of dividend payments. There is a combination of legal and economic factors which are an integrated part of the plaintiffs' property and property rights. (Judicial notice may be taken of the notorious fact that non-callable preferred shares listed on the New York Stock Exchange sell at a heavy premium.) Plaintiffs' owner-



ship of defendant's second preferred shares includes a unique proprietary interest in defendant's business arising out of both the priorities and preferences and the permanency of the investment. The latter factor is, in view of defendant's acknowledged financial success, a vital element in fixing the value of the shares. A destruction of the element of permanency will immediately destroy a definite and fixed part of the value of defendant's shares owned by the plaintiffs. Therefore, the power of amendment should not be construed to include the power to destroy this value.

It is difficult to believe that the people in adopting the Constitution and the legislature in enacting legislation to implement this reserved power of amendment intended to confer authority either upon the State or upon corporations and their stockholders which would enable the State or a majority of stockholders as the delegatee of this reserved power to destroy the property rights of a minority group. This would indeed be the "tyranny of the majority," and would represent the exact opposite of the principle which has always motivated the political philosophy of the United States—that of protecting the minority from the unreasonable or oppressive action of the sovereign power exercised either by the legislature or by a majority of electors. This principle is a fundamental tenet in our constitutional government, and a departure from it in construing the statutes in question could be justified only as an exercise of the police power. It has never been asserted that the exercise of this reserved power to

amend corporation laws was an exercise of the police power, and none is made in the case at bar.

It is therefore submitted that (1) the history of the constitutional reservation of power to amend corporation laws and corporate charters; (2) a fundamental tenet in the political thought of the Nation with respect to the relationship of minority and majority groups; and (3) the decisions of courts and the opinions of legal scholars, all support the conclusion that the power to "amend in any respect" does not include the right of the majority of defendant's stockholders to destroy the valuable right of plaintiffs to own and hold their preferred shares free from the threat of involuntary retirement of same.

## II.

THE PHRASE "MAY BE AMENDED IN ANY RESPECT," CONTAINED IN SEC. 338, R. S. 1898 AND IN SEC. 18-2-44, U. C. 1943, IS NOT UNLIMITED IN ITS OPERATION AND MUST BE CIRCUMSCRIBED BY AN INTERPRETATION AND CONSTRUCTION WHICH WILL PROTECT THE RIGHTS OF MINORITY STOCKHOLDERS FROM OPPRESSION AND ABUSE OF POWER BY THE MAJORITY OF STOCKHOLDERS.

1. Changes in the rights of outstanding shares of corporate stock can be justified under said statutes only when the exigencies and needs of the corporation require it.
2. The exercise of the reserved power to amend, alter or repeal by a majority of stockholders of a corporation should never be sustained when such exercise of power

**substantially impairs the rights of minority stockholders.**

The phrase "may be amended in any respect" is capable of a wide variety of interpretations, and the decisions of the courts reveal differences which are difficult to reconcile. However, leading jurisdictions which hold that under this reserved power to amend there is no vested right in the stockholders to maintain their rights and privileges under the articles of incorporation or charter, nevertheless, definitely limit the exercise of this power of amendment by the majority of stockholders, and approve only amendments which can be justified by an exercise of fair business discretion and judgment or which the exigencies of business or the financial condition of the corporation demands. Professor Ballantine of the University of California Law School and author of *California Corporation Law* writes in his 1949 Edition as follows:

"There are two main classes or types of amendment which have consequences in the safeguards provided: first, those amendments which have a similar effect on all the shareholders as a body and make some change with respect to the enterprise as a whole, such as a change of purposes; second, those amendments which permit a specified majority to change the rights and relations as between different classes of shares and thus change the proportional rights of individual shareholders to participate in the enterprise. This latter type of amendment is the one that has caused great trouble in the courts as to what protection should be given against discrimination and abuses of power, particularly as respects preferred shareholders.

"The safeguard primarily relied upon in amending statutes for the protection of members of a class of shares adversely affected by an amendment is the right of a class vote. (*Johnson v. Bradley Knitting Co.*, 228 Wis. 566, 280 N. W. 688, 117 A. L. R. 1276; note, (1944) Wis. L. Rev. 65, 66.) In California a two-thirds vote is required, in other states the required percentages are about evenly divided between a one-half and two-thirds class vote. There is some variation in the specification of those amendments which are regarded as requiring a vote by classes, particularly as to the creation of a new class of shares having prior rights and preferences over an existing class, or an amendment as to the purposes of the corporation.

This rule was applied in *DeMello v. Dairyman's Cooperative Creamery*, 73 C. A. (2d) 746, 167 Pac. (2d) 226. The following example is indicative not only of the rule itself, but of its application:

"Mr. Ballantine in his *California Corporation Law* (1938 ed.) at page 9 in section 7, comments on the right of a corporation to change its financial structure as follows:

" 'Changes in the rights of outstanding shares may be valid if they can be justified as an exercise of fair business discretion in meeting the needs and exigencies of the corporate enterprise. The more urgent the need or the emergency the more drastic the amendment or adjustment which fairness will permit, as in changing preferences and financial arrangements according to what the enterprise can carry. The facts and circumstances of each case will enter into the determination of the validity of the exercise of the power in that case.'

“The evidence in this case indicates that the membership structure of the creamery had caused internal dissension and was hampering the corporation as well as compelling it to pay out unnecessarily, considerable sums in federal income taxes; that it was impossible to repay to members the full value of their interests without winding up its affairs. It also appears that all members were treated alike in the reorganization in so far as the valuation of the individual interests are concerned as well as the repayment of that valuation and that plaintiffs and their assignors, had they consented to the reorganization plan, would have received \$100 in cash, which was the same amount they would have received from the creamery upon voluntary withdrawal from it, and in addition will receive \$965 in deferred payments. There seems to be nothing unfair in this procedure and it is intended to settle the internal troubles of the association. This brings the case within the rule announced by Mr. Ballantine which we believe is a correct summary of the law applicable here. Certainly the reorganization plan did not violate any vested contract or property rights held by plaintiffs so it cannot be held to be unconstitutional on the grounds urged by them.”

This doctrine finds an interesting example in a Canadian case entitled *Re Western Grocers* (1936; Manitoba) 2 West. Week. Ret. 81, 2 D. L. R. 762. It was proposed to amend the articles of incorporation to render the preferred shares, which, as issued, contained no provision for redemption, redeemable at par plus 10 per cent. It appeared that the company's preferred shares were quoted on the stock exchange at \$107 per

share and the common shares at \$49. The net worth of the company was such that after the redemption of all the outstanding preferred shares at \$110 (such shares having a par value of \$100), sufficient assets would remain to give the common shares a book value of \$85.98. The court wrote:

“It is self-evident that the scheme is one calculated for the benefit of the holder of common shares at a sacrifice of the preferred shareholders of the loss of their investment. Is it such a scheme as reasonable men of business might properly and reasonably approve? The court will not sanction an arrangement unless it is fair and equitable to all the parties interested. \* \* \* The opinion I have formed, and I feel that I ought to express it, is that the strong financial position of the company and the total absence of any necessity for any assistance or protection and the evident intent being to improve the position of the holders of the common shares the injustice to the preferred shareholders in depriving them of the benefit to which, by risk of their initial investment of the company, justly entitles them to, leads me to the irresistible conclusion that this is not the reasonable and fair scheme.”

It appears that the jurisdictions which have established this test are operating under constitutional and statutory provisions with reference to amendment of articles of incorporation as broad as those of Utah, and that these jurisdictions are committed to the doctrine that the constitutional and statutory provisions existing at the time of incorporation are written into the articles of incorporation as if set forth therein in extenso. (Cf. 13 Am. Jur. Corporations, Sec. 90, p. 234.)

Professor Ballantine's doctrine as quoted in the *DeMello* case, supra, is clearly indicative that the rule finds its source in the well-established principle that a court of equity possesses the power to protect minority stockholders against unjust and unfair action on the part of majority stockholders.

"It is well established that courts of equity will entertain jurisdiction in the instance of minority stockholders of a private corporation who are unable to obtain redress within the corporation and have no adequate remedy at law, to restrain, threaten ultra vires acts on the part of the majority or to prevent any other act on the part of the majority which may be denominated as a breach of trust or a breach of the fiduciary duties owing to the minority." (13 Am. Jur. Corporations, Sec 424, p. 476.)

If it be the conclusion of the court in the instant case that the reservation contained in Section 338 of Revised Statutes 1898, which provided that the "articles of incorporation \* \* \* may be amended in any respect," is sufficiently broad to permit the alleged amendment of November 10, 1947, the duty still remains upon the court to determine whether or not the alleged amendment, considering all of the facts and circumstances of this case, is a valid exercise of the reserved power of amendment.

According to the Ballantine doctrine, after a court has found the necessary reserved power in the State to authorize corporate action which directly affects or changes property and property rights of stockholders, and has decided that applicable statutory provisions

confer authority upon the corporation to alter or change the stockholders' interests and rights, the courts are still faced with the consideration of the fairness and equity of the proposed scheme, although, of course, the fairness of any plan cannot supply the necessary legal authority to execute it.

A study of the court decisions of the past 15 years involving the same problems as are involved in this case indicates that they have moved in cycles. Economic and industrial demand, plus the chaotic situation incident to the financial upheaval of the 1930s, influenced the courts to give an expansive interpretation of the reserved power of amendment. However, this trend now shows signs of being halted. When the emergent situation passed, it was seen that injustice was being inflicted upon innocent persons who had invested their savings in corporate securities on the strength of agreements contained in the articles of incorporation of issuing companies. These investors were subjected to loss of certain rights through the operation of this reserved power of amendment. The legalistic reply that the investor acquired his stock charged with knowledge of this reserved power of amendment did not meet the situation where the reorganization plan was apparently unfair or unjust. The courts commenced to draw back from the idea that the fairness or unfairness of the corporate action could not be considered where the action was in exercise of power conferred upon the corporation by the act under which it was organized. The reaction is now making itself felt, and hence it is that the courts,



after affirming the power, examined into the fairness and equity of any plan.

The court in its decision in *Havender v. Federal United Corporation* (1940), 24 Del. Ch. 318, 11 At. (2d) 331, declared that the legal right of the company to cancel the stockholders' claim to accrued, accumulated dividends was subject to the qualification that such plan was fair and equitable with the prescribed method to secure such fairness. In 1947 the Federal Court, in *Langfelder v. Universal Laboratories*, (C. A. 3d Del.) 163 Fed. 2d 804, declared that in destroying the rights inherent in shares of stock, the plan must meet the test of a court of equity that it is not unfair, inequitable, or fraudulent. The doctrine was again applied in *Porges v. Badsco Sales Corporation*, 1943, 32 At. 2d. Del. Ch. 148. See also *Hottenstein v. York Ice Machinery Corporation*, 136 Fed. 2d (C. A. 3d Del.) 944, for definitive application of the rule. In the case of *Wessel v. Guant-anamo Sugar Company*, 134 N. J. Equity 271, 35 At. 2d 215, 135 N. J. Equity 506, 39 At. 2d 431, the plan or reorganization was declared to be so unfair and inequitable as to be illegal. The court in this case asserted that the scheme was for the benefit of the common stockholders.

In another New Jersey Case, *Kamena v. Janssen Dairy Corporation* (1943), 133 N. J. Equity 214, 31 At. 2d 200, 134 N. J. Equity 359, 35 At. 2d 894, the court, in substance, concluded that the plan of reorganization lacked an essential element of justice or equity because

of the failure of the plan to make provision to compensate minority stockholders for their losses.

The requirement that a court examine a plan of corporate reorganization or an amendment to the articles of incorporation affecting the stockholders' rights, with the view of determining the necessity for such plan and its effect upon stockholders, is a judicial safeguard which is highly necessary if the reserved power of amendment is to be construed as being comprehensive and plenary. Such rule in no respect limits the power of the State to supervise its corporate creatures, but it does protect minority stockholders from over-reaching by the majority group. It is a desirable curb upon the will of the majority which protects the minority without handicapping the State in the exercise of its proper function, and without "straightjacketing" a corporation which may be in financial difficulties and worth preserving. It is a salutary rule and one that commends itself for its simplicity in application and its effectiveness in reaching the ends of justice. It correlates an unlimited reserved power of amendment as a theoretical governmental function with the practical aspects always involved in this type of case.

- 1. Changes in the rights of outstanding shares of corporate stock can be justified under said statutes only when the exigencies and needs of a corporation require it.**

There is no claim nor assertion in the pleadings in this action that the defendant's financial condition is other than sound. The plaintiffs alleged (R. 17) and the

defendant admitted (R. 34, 35) that the value of the fixed assets of the company is in excess of a million dollars; that the value of the working capital and inventories is in excess of two million dollars; that during the period of its existence the defendant has earned large profits; that, except for current liabilities, it is free from debt; and that its credit standing is among the highest of all commercial and industrial concerns doing business in the intermountain country. With these admissions, the conclusion is free from all doubt that the defendant on November 10, 1947, and at the time of the commencement of this action was not only solvent but, also, was a prosperous merchandising concern, earning large profits. Further, the pleadings do not reveal that there is any internecine dispute or controversy existing between the stockholders, directors, or officers of the company, except for the present controversy. The defendant has not denied, nor will it deny, the statement that in its present condition it is a superb example of successful American industry.

Therefore, there is not presented by the pleadings any situation similar to that described in the *DeMello* case, supra, whereby the corporate structure had caused dissension among the stockholders which had hampered the company's operations, as well as compelling it to pay exorbitant income taxes. There is not present in the case any claims of creditors, and the record may be searched in vain to discover any situation which demands a reorganization of the stock structure of defendant. Defendant admits:

“That at the present time it believes it can borrow funds for financing its operations at a rate of interest less than six (6) per cent per annum, and upon that basis (if the class 2 preferred stock be retired), the source from which dividends on common stock may be paid will be increased somewhat.” (R. 36.)

This admission explains the underlying purpose of the alleged amendment of November 10, 1947.

The conclusion must be that there is disclosed on this facet of the case no facts or circumstances which demand that plaintiffs' stock ownership be modified or changed. The company does not face insolvency or liquidation. Its finances are in splendid condition and there is nothing in the pleadings to disclose an emergency condition which demands radical treatment in order to sustain defendant's business operations. The only purpose for eliminating the class 2 preferred stock is to reduce the interest charge on funds used in the operation of the company. (R. 36.) Under the circumstances disclosed by the pleadings, the exigencies and needs of the defendant do not require the elimination of plaintiffs' preferred stock.

2. **The exercise of the reserved power to amend, alter or repeal by a majority of stockholders of a corporation should never be sustained when such exercise of power substantially impairs the rights of minority stockholders.**

The defendant in its answer (R. 34, 35) to Paragraph IV of plaintiffs' third cause of action (R. 17) admitted the following facts:

"That the defendant company has for nearly 50 years last past engaged in the commercial activities for which it was incorporated, with its principal office and place of business in Salt Lake City, Utah; that the business has expanded and grown and defendant now owns and operates large branches at Boise, Idaho, and Grand Junction, Colorado; that in said three cities it has constructed, owns, occupies, and operates extensive warehouses and offices; that the value of its fixed assets is in excess of a million dollars; that its working capital and inventories are also valued in excess of two million dollars; that during said period the defendant company has earned large profits \* \* \*. That, except for current liabilities, it is free from debt and its credit standing is among the highest of all commercial and industrial concerns doing business in the intermountain country." (R. 17.)

The defendant in its answer admitted:

"That during the period of 50 years last past, the defendant company has paid regular dividends due upon its preferred and common stock, except that during the years 1931 and 1932 it paid no dividends on its common stock." (R. 35.)

Defendant further admitted that the dividend record of the company has made its class 2 preferred stock a desirable investment. (R. 35.)

These admissions show that the class 2 preferred stock of the company holds a unique position in the financial structure of the defendant. There were outstanding at the time of the special meeting of the stockholders on November 10, 1947, 11,961 shares of the capital stock of the company, of which amount 10,135

shares were common stock and 1,826 shares were class 2 preferred stock. The plaintiffs are the owners of 1,501 shares of the total of 1,826 shares of class 2 preferred stock.

Here, then, is a corporation possessing assets and properties of the approximate value of three million dollars, free from debt, represented by 11,961 shares of stock, and each share, therefore, possesses an equity value of about \$250.

While it is true that the class 2 preferred stock, upon dissolution or liquidation of the company, will only be entitled to \$100 per share, the fact remains that each share of preferred stock has an equity of about \$250 in the assets of the company to guarantee the annual dividend of six (6) per cent on par. It is manifest, therefore, that so long as the company remains in operation and is not liquidated, that each share of class 2 preferred stock, if not subject to redemption, possesses an inherent value in excess of its par value of \$100. With the acknowledged financial success of the company over a period of nearly half a century and with a guaranteed dividend rate of six (6) per cent on par, the conclusion is irrefutable that these preferred shares occupy a most distinguished investment position in the intermountain country. If they are non-callable and cannot be redeemed, this aspect of their ownership is a substantial element of their value on the open market. The guaranteed dividend of six (6) per cent, supported by a \$250 equity, and the fact that shares are not subject to redemption produces an unusual and most profitable

investment. It is obvious that the element of non-callability is one of the three dominant factors determining the market value of this stock. If these shares are subject to redemption, as the defendant contends, then one of the primary elements of value is totally destroyed. These are facts reflected by the record, and the deduction is clear that the making of these shares redeemable will take away from the preferred stockholders a real and genuine element of value and property. The value factors herein discussed are most pertinent and relevant, and should not be ignored by the court. Whether the non-redemption privilege is a "vested" property right, or whether it is a preferential privilege only, a realistic analysis of the elements giving value to these shares compels the conclusion that the elimination of the non-redemption privilege will substantially damage preferred stockholders.

If, however, these shares cannot be redeemed at the will of the defendant, the open market value of the shares, in view of the successful financial history of the company, will be substantially above par. On the other hand, if these shares are redeemable, this premium will disappear automatically and the value of the shares will be but par or less. This situation calls for equitable relief, in order to protect the investments of these stockholders against partial emasculation.

It is not difficult to imagine supposititious cases which prove that the phrase "may be amended in any respect" cannot be applied literally in determining the validity of the alleged amendment of November 10, 1947:

(a) If, for example, the articles had been amended to change the preference on the preferred stock to \$1.00 per share on liquidation instead of \$100 per share, the result would be so shocking to the sense of justice and fair play of the court that such amendment would be declared null and void.

(b) If, for example, the articles had been amended so as to provide that the preferred stock should be redeemable at \$1.00 per share instead of \$100 per share, the corporation being in its present financial condition, it is certain that no court in the land would sustain such amendments.

These examples are not far-fetched situations, if the theory is adopted that the phrase in question is unlimited in its application and scope. Obviously, there must be a limit beyond which a corporation cannot go in exercising this reserved power of amendment. The doctrine set forth by Professor Ballantine has direct and immediate application in order to prevent abuse of power by the majority of stockholders.

The examples given and the alleged amendment of November 10, 1947, while differing in degree in their impact on the preferred stockholders' rights, are in the same category. If the defendant can change non-redeemable preferred stock to redeemable preferred stock, there is no limit to the power of the majority of stockholders (whether it be a simple majority or a two-thirds majority or a three-fourths majority). The court should refuse to accept a literal reading of the questioned



phrase and assert the right of examining the surrounding facts and circumstances in each case to determine whether or not an amendment meets the test of fairness, justice, and equity. If this rule is adopted in Utah, it is submitted that the alleged amendment of November 10, 1947, cannot stand, because it represents an abuse of power of the majority of stockholders.

Plaintiffs, in submitting the foregoing argument in support of their contention that the phrase "may be amended in any respect" cannot be applied literally, take cognizance of two decisions in the Supreme Court of Utah relating to and construing the reserved power of amendment of articles of incorporation. Reference is made to the following decisions: *Salt Lake Automobile Company v. Keith O'Brien Company*, 45 Utah 218, 143 Pac. 1050; and *Weed v. Emma Copper Company*, 58 Utah 524, 200 Pac. 517. The defendant in the lower court relied heavily upon these two cases to support its contention that its alleged amendment of November 10, 1947, was a valid exercise of the reserved power of amendment.

The *Salt Lake Automobile Company* case involved an amendment which created a new class of preferred stock having priority over a previous preferred issue and the common stock of Keith O'Brien Company. Plaintiffs sought an injunction against the issuance of the new preferred stock. The following quotation from the decision in this case strikingly reveals the underlying reasoning for the court's decision upholding the validity of the amendment:

"In no event has a preferred stockholder a specific lien upon the assets of the corporation. At most he has but a conditional promise or obligation of the corporation to pay, and in case the corporate business is discontinued, and its affairs are wound up, he, as against the common stock, or inferior classes of preferred stock, may be, and ordinarily is, entitled to preference. He, however, by reason of the right to amend and change the articles of incorporation, takes his stock subject to such right. In the very nature of things, therefore, the issue and sale of preferred stock cannot affect the rights of stockholders, whether holders of common or preferred stock, in a greatly different way than such right is affected by the issue of promissory notes or other unsecured obligations. Such obligations do not, as against the company or its creditors, constitute liens like mortgages.

"In the case at bar no one could have doubted the right of the company to secure funds by mortgaging its assets, if it were done in good faith to protect its credit or to further its business interest. Had it done so, appellant's stock and his right to dividends would have been subject to the indebtedness so created and secured, whether it were large or small. Are his legal rights or the value of his shares of stock affected in a different way or to a greater extent by the issue of the Class A stock than would have been the case by the issue of bonds, or even by the giving of promissory notes secured by mortgage upon the property of the company? \* \* \* If to amend the articles of incorporation so as to issue preferred stock and to classify the same invades a constitutional right, then, of course, a business rival who is a stockholder may prevent the amendment without giving his consent, and no one could

complain. If, however, to so amend the articles does not invade such a right, then he may not complain, although it may affect the value of his stock. The latter might be the affect upon his stock in case of a mortgage or other pledge of the corporate property to secure a debt, and yet no one contends that he could prevent the giving of a mortgage, if necessary to raise funds, and of the necessity to do so the governing body of the corporation, if acting in good faith, would ordinarily be the judge. No one doubts that a majority of the stockholders could authorize a loan and a pledge of the corporate property to secure its payment."

The *Weed* case involved the power and authority of Emma Copper Company to convert non-assessable shares into assessable shares by amending its articles of incorporation. In sustaining the company's right to do this, the court wrote:

"In arriving at such conclusion we are not unmindful of the plaintiff's contention that fully paid stock is the property of the stockholder and that by forfeiting the same his property rights are affected. *The contention to our minds is, however, not applicable here.* If, for example, the corporation is indebted and no assessments may be levied to raise funds to pay such indebtedness, judgment may be obtained against it and all of its assets sold to pay the same. It might just as logically be contended, therefore, that that may not be done because it deprives the stockholder of his interest in the corporation and thus affects his private property rights. His stock merely represents whatever interest he may have in the property or assets of the corporation. If the corporation has no property or assets, or is

insolvent, his stock is necessarily worthless. If, therefore, an assessment is levied upon his stock to pay debt and he and the other stockholders fail to pay the same and the property of the corporation is sold to satisfy the indebtedness, each stockholder is precisely in the same situation, and no worse, than if his stock is forfeited for non-payment of the assessment." (Emphasis supplied.)

The Supreme Court, in these decisions, used as its measuring rod the economic aspect of the situation with respect to corporate debts and the rights of creditors. It is earnestly suggested that in both of these cases the court reached the conclusion that no contract or property rights of the plaintiffs were being impaired or destroyed by the corporate action involved, because those contract and property rights could be impaired or destroyed through creditors' action which, theoretically, at least, could be prevented by the sale of preferred stock (as in the *Salt Lake Automobile Company* case), or by levying of assessments (as in the *Weed* case). It is significant that in both of these decisions the court in principal part justifies its conclusion that no substantial contract or property rights of the plaintiffs were affected by introducing into its line of reasoning the rights of creditors. It would seem that the court has already committed itself to Professor Ballantine's doctrine and has not attempted to read and apply the phrase "may be amended in any respect" literally. Had that been the process of the court, it could have quickly reached its decisions in both cases by declaring that the phrase contemplated any and all kinds of amendments,

regardless of their effect upon minority stockholders. It did not follow this course of reasoning, as it apparently sensed the fact that a situation could, or would, arise where such overall interpretation would result in grievous wrong being inflicted upon dissenting stockholders if it opened the gates to unlimited amendments. (Note the emphasized sentence in the passage from the *Weed* case.) Accordingly, the plaintiffs assert that the holdings of these two decisions do not foreclose the Supreme Court from giving affirmative assent to Professor Ballantine's doctrine, in that these decisions may be easily explained as being but one aspect of the whole problem. There will be nothing inconsistent in the position of the court if it holds that the amendment involved in this action is invalid because of its unfair effect upon the plaintiffs' rights in the absence of any economic factor involving the financial stability of the defendant. Rather, such conclusion will be consistent with the position of the court exhibited in the two decisions above discussed, as it will consider the need of a corporation to effect a proposed amendment and its ultimate repercussion upon the stockholders. It is further relevant to mention the fact that the amendment approved in the *Salt Lake Automobile Co.* case affected all of the common stock and all of the second preferred stock, equally, and that the amendment approved in the *Emma Copper Company* case affected all of the outstanding shares of stock of the company equally. There was no discrimination in either case against any class of stockholders. In the case at bar the alleged amendment is aimed directly at

the second preferred stockholders and affects only their rights.

By a supplemental answer (R. 39, 40), the defendant alleged that on March 16, 1948, at a special stockholders' meeting, an amendment was adopted extending the life of the corporation by a period of five years, and that the stock owned by the plaintiffs was represented at that meeting and voted in favor of the amendment. The holding of the Supreme Court in *Fower v. Provo Bench Canal and Irrigation Company*, 99 Utah 267, 101 Pac. (2d) 375, that laws in force at the time of the extension of the corporate life of the company forms a part of the contract between the corporation and its stockholders, does not in any respect influence or impair the arguments of plaintiffs herein made. The provision of Section 338, R. S. 1898, is the same as is found in Section 18-2-44, Utah Code 1943. Therefore, if the 1898 provision is wholly ignored, the 1943 Code section becomes controlling. Plaintiffs' contentions, as herein made, are applicable and equal to both statutes. Needless to state, if the November 10, 1947, amendment is invalid, it would be invalid from its inception and would form no part of the articles of incorporation of the company. As a consequence, the action of the plaintiffs in voting to extend the corporate life of defendant in no way changed their position nor impaired their right to question in this action the 1947 amendment.

WHEREFORE, plaintiffs respectfully submit that the court should declare that the alleged amendment of

November 10, 1947, of defendant's articles of incorporation is invalid and void.

Respectfully submitted,

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