

**THE RIGHTS AND WRONGS  
OF HELPLESS  
STOCKHOLDERS AND OF A  
HELPLESS CORPORATION**

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The Rights and Wrongs of Helpless Stockholders and of a Helpless Corporation by A. Layman

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THE  
RIGHTS AND WRONGS  
—OF—  
HELPLESS STOCKHOLDERS  
AND OF A  
HELPLESS CORPORATION.

Thou shalt not covet thy neighbor's house : thou shalt not covet thy neighbor's wife,  
nor his man-servant, nor his maid-servant, nor his ox, nor his ass, nor anything that is  
thy neighbor's.—*The Decalogue.*

The attempt and not the deed confounds us.—*Lady Macbeth.*

BY A LAYMAN.



NEW YORK :  
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1887.

## PREFACE.

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The following pages are dedicated to stockholders generally, and more particularly to the common stockholders of the St. Paul and Duluth Railroad Company.

The wrongs complained of are such as could be remedied only by an appeal to the Courts. That appeal has been made, and will be prosecuted till it is judicially settled whether or not the control of Directors exonerates them from all liability to the corporation or the stockholders for unlawful acts, and whether the positive duties of trustees can be successfully evaded under the pretense that they are merged in the discretionary power of Directors.

NEW YORK, April 10th, 1887.



THE  
RIGHTS  
- OF -  
HELPLESS STOCKHOLDERS.

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THE judicial current for many years set very strong in favor of recognizing in Directors of corporations a power the Court would not disturb. The inclination has been to leave them in the hands of the stockholders, and to give the stockholders no other remedy for any wrong than such as they could derive from a change of their agents. But cases came before the courts in which complaining stockholders had no voice in the choice of Directors. It was impossible for them to change their agents. The question then arose whether there were wrongs incapable of remedy, and the judicial current changed.

The present inclination of courts is to confine within legal boundaries and limitations the control vested in Directors; to recognize more distinctly and more largely than heretofore the rights of the individual stockholder, and to aid his assertion of them. The Supreme Court of the United States has given expression to this sentiment when it repudiates the idea that illegal transactions of Directors can be regarded as "condoned" or "legalized" because



"helpless stockholders," who could not change the Directors, have failed to "undertake the burden of such gigantic controversies as are involved in the railroad transactions of the present day." Instead of perilling their rights, their "helplessness," in the judgment of the court, only aggravates the wrong. The Supreme Court has thrown out the signal, and the Circuit and District Courts have taken note of it, and many recent cases show a judicial determination that the "control" of Directors must be strictly exercised within the law and within the charter.

The recent valuable work on the law of stock and stockholders, by Mr. Cook of the New York bar, devotes an important chapter to the Frauds of Directors in corporate institutions, and more particularly in railroad companies. Of latter years, he says, the highest talent has been employed in the spoliation of corporations and stockholders, sometimes by the old and familiar methods of fraud, but more frequently by the invention of new methods, such as undue increase of dividends, the payment of unearned dividends, the arbitrary withholding of dividends that are fairly earned, the use of corporate income for improvements, whereby dividends are cut off until the managers have purchased all the stock they want at prices far below the real value. This writer devotes a pregnant paragraph also to the frauds practised by a majority of stockholders on the minority, by exercising their "control" otherwise than in the "utmost good faith," as by conspiring to compel a minority, with different interests, to consent to fundamental changes in their charter, and the surrender of a large and valuable portion of their property as

the inexorable condition of being permitted to enjoy the beneficial use of the remainder.

These topics are all illustrated in Mr. Cook's interesting volume with much acuteness of analysis and a large citation of authorities.

It is my purpose in the present essay to show that all these methods figure more or less in the history of the St. Paul and Duluth Railroad Company. I shall also endeavor to show that methods not mentioned in the above enumeration, but entirely novel and unprecedented, have been so practised by the managers of that corporation as to fully entitle them to the credit of all the subtlety, enterprise and audacity which Mr. Cook ascribes to the most finished achievements in this department of industry.

The St. Paul and Duluth Railroad is an outcome from the reorganization of the Lake Superior and Mississippi Company, which at the time of its failure had outstanding \$4,492,000 first mortgage bonds and \$3,200,000 second mortgage bonds, besides notes and certificates which had been given for money borrowed to pay previously maturing coupons and for floating indebtedness. All these obligations represented money that had been put into the road, to aid in the construction of which a large land grant had been made by the United States and the State of Minnesota. In order to procure the necessary legislation, to quiet opposition, and to preserve the integrity of the enterprise it was indispensable to provide equitably for the junior securities and to do something, however inconsiderable, for the \$5,000,000 of common stock. The old road, therefore, was foreclosed under an agreement that merged all pre-exist-

ing rights and interests in a plan of reorganization, that was made the charter of the St. Paul and Duluth Railroad Company. To this Company the original stockholders of the old corporation were admitted on the basis of one new share for every twenty old shares. Thus it will be seen that the entire stock to be issued to the new Company substantially represented actual cash paid up, for it is not to be supposed that the original stockholders obtained their franchise without an expenditure of time, labor and money.

Without regard to the name by which they were designated, and with no implication whatever of any superior equities in one class over the other, a binding agreement was made between the two classes of stockholders, by which certain rights and interests, clearly defined and intended to be strictly secured, were severally assigned to the two contracting parties. It was a perfectly fair covenant. No advantage could have been taken of either side. We may suppose that the first mortgage bondholders had a paramount influence in framing it; but even at that time it was a question with those who believed in the future of Duluth which class had the better end of the bargain.

This plan vested in the so-called preferred stockholders a lien on the property, to the extinguishment of which the net proceeds of the land grant and the surplus profits of the railroad, after the payment of seven per cent. on the preferred and six per cent. on the common stock were set apart and devoted.

The reorganization was finally completed on the 27th of June, 1877, by the due promulgation and cer-