Corporations - Preferred Stockholders as Creditors - Redemption Agreements

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RECENT DECISIONS

CORPORATIONS—PREFERRED STOCKHOLDERS AS CREDITORS—REDEMPTION AGREEMENTS.—In 1919 plaintiff paid defendant corporation $1,000 for a certificate of ten shares of preferred stock. Prior to the purchase plaintiff was told by the officers of defendant and it was so stated on the certificate, that the stock would pay 7% per annum, that the dividends were guaranteed, that the stock would be redeemed in full in 1929, and that the stock would constitute a preferred claim on the assets of the company. In 1929, in conformity with the terms of the certificate, plaintiff gave notice to the defendant that he desired to have his stock redeemed and all “interest” thereon paid. The defendant, though solvent, refused to redeem and pay up the “interest.” Action to reduce plaintiff’s alleged claim to judgment, which would constitute a preferred lien on the assets of defendant, and to foreclose such lien. Demurrer by defendant sustained, and judgment given against plaintiff upon his refusal to plead further; plaintiff appeals. Held, that the complaint states a cause of action to have the stock redeemed. Judgment reversed with instructions to overrule the demurrer. Cring v. Sheller Wood Rim Mfg. Co., (Ind. 1932) 183 N.E. 674.

Plaintiff was a stockholder of defendant company and not a creditor. Spencer v. Smith, 201 Fed. 647 (C.C.A. 8th, 1912); Warren v. Queen & Co., 240 Pa. 154, 87 A. 595 (1919). The purchase of stock is not a loan to the company. Warren v. Queen & Co., supra; Booth v. Union Fibre Co., 142 Minn. 127, 171 N.W. 307 (1919). A preferred stockholder is entitled to have his stock redeemed at maturity if the company is solvent, so that redemption can be done without prejudice to the rights of creditors. 14 C.J. 507; 7 R.C.L. § 171, p. 201; Koeppler v. Crocker Chair Co., 200 Wis. 476, 228 N.W. 130 (1930); Westerfield-Bonte Co. v. Burnett, 176 Ky. 188, 195 S.W. 477 (1917). The burden is on the stockholder to show that the company is solvent and that redemption can be made without prejudice to the rights of creditors. Koeppler v. Crocker Chair Co., supra. Even where corporate creditors surrender notes of the company and receive preferred stock in lieu thereof, they cease to be creditors, and in respect to the remaining creditors of the company occupy the position of stockholders. National Electric Signaling Co. v. Fessenden, 207 Fed. 915 (C.C.A. 1st, 1913); Warren v. King, 108 U.S. 389 (1883). Even though the certificate of preferred stock says that “the holder of this certificate shall have a preferred lien on the assets of the corporation,” no such lien attaches, the preferred stockholder getting at most a preference over common stockholders in case of liquidation. Weaver Power Co. v. Elk Mountain Mill Co., 154 N.C. 76, 69 S.E. 747 (1910). “Any attempt to give preferred stock any preference, either in respect of payment of principal or dividends which will be superior to the rights of creditors, unless by virtue of express statutory authority, . . . is contrary to public policy and void.” Koeppler v. Crocker Chair Co., supra at 481. However, the courts generally construe such certificates as merely giving the right to redemption when the company is solvent, can pay all outstanding debts, and when such redemption will not in any way harm creditors. Koeppler v. Crocker Chair Co., supra; Warren v. Queen & Co., supra; Westerfield-Bonte Co. v. Burnett, supra.

Although the ruling in the instant case is well-settled law, the public is constantly being misled by the inducements in the certificates, which indicate an apparently fool-proof investment. Owen, J., concurring in Koeppler v. Crocker Chair Co., supra at 484, says: “Such an agreement in a stock certificate is a trap and a snare for the unwary investor. He is deluded into the belief that
he has a contract and that he has acquired contract rights. It were better public policy to prohibit entirely the issuance of such contracts. * * * I suggest that the matter may well receive the serious consideration of the legislature.”

VINCENT T. HARTNETT

EMPLOYMENT CONTRACTS—RESTRAINT OF TRADE—INJUNCTIONS. — Defendant had been employed as driver of the plaintiff’s wagon, collecting and delivering towels on one of the plaintiff’s routes for eleven years. In 1930 he was made route foreman, and thereupon he entered into a contract with the plaintiff whereby the latter agreed to pay him a stated wage, and the defendant agreed that he would not within two years after leaving plaintiff’s employ in any way carry on a similar business with the plaintiff’s customers. The contract could be terminated by either party by a two weeks’ notice. In 1932 the defendant was discharged. He sought employment elsewhere, but was unable to find it. Because of a physical disability, his appearance made it quite impossible for him to secure work in most other lines. He then entered into the employ of a competitor of the plaintiff, and now the plaintiff seeks to enjoin him from continuing such work. Held, injunction denied. The contract is an unreasonable restraint of trade and therefore unenforceable. Milwaukee Linen Supply Co. v. Ring (Wis. 1933), 246 N.W. 567.

A bargain is in restraint of trade when its performance would limit competition in any business or restrict a promisor in the exercise of gainful occupation. Restatement of the Law of Contracts, Sec. 513, (1932),2 and is illegal if the restraint is unreasonable. Ibid, Sec. 514; 4 Harv. L. Rev. 128ff (1890). Society has an interest in such contracts and will protect itself by protecting individuals who have become parties to such, depriving themselves of individual freedom and endangering their means to a livelihood. However, reasonable restraints will be allowed. Restatement of Contracts, Sec. 515; 31 Harv L. Rev. 193 (1917). The test of reasonableness is less stringent in the case of sales contracts than in employment contracts, for the vendor is in a better position to protect himself in the sales contract than the employee in the employment contract. 34 Harv. L. Rev. 555 (1921), but see Eureka Laundry Co. v. Long, 146 Wis. 205, 131 N.W. 412 (1911), in which Vinje, J. says there is no reason for a distinction. The restraint is unreasonable if it is greater than required for the protection of the person for whose benefit it is imposed. Restatement of Contracts, Sec. 515-a; Berlin Mach. Works v. Perry, 71 Wis. 495, 38 N.W. 82 (1888). The restraint must be qualified as to time, place, and circumstance. Restatement of Contracts, Sec. 515, comment C: Berlin Mach. Works v. Perry, supra. But such limitations

1 In My Laundry Co. v. Schmeling, 129 Wis. 597, 109 N.W. 540 (1906), Marshall, J., stated that evidence that the defendant depended for a livelihood upon work in the industry from which he is restrained by the contract is properly excluded as being irrelevant. But this does not seem to be the general practice, for many cases including the present have been decided at least in part on such evidence.

2 This is one of the first Wisconsin cases in which the Restatement of the Law of Contracts is cited. Mr. Chief Justice Rosenberry of the Wisconsin Supreme Court stated before the Milwaukee Bar Association last January, “The propositions laid down in the restatement would, by reason of the carefulness and thoroughness in which they are made, be accepted as a correct statement of the law and that anyone who claimed that the propositions there laid down were not correct statements of the law would have the burden of overthrowing the statement.”