

## EATING YOUR LOAF AND HAVING IT

The law recognizes the fact that the stockholders of a corporation are entitled to certain rights and privileges which the directors are bound to respect, and which the courts will protect, although many directors act as if such were not the case.

It follows that in certain cases where the directors have acted improperly or illegally, the stockholders on behalf of the corporation may sue the directors for such breach of duty and compel them to reimburse the corporation for any loss, and to place the corporation in the same position which it occupied before the illegal act.

It is also elementary corporation law that the directors cannot pay dividends except out of the surplus profits of the corporation, and cannot use the capital for that purpose.

Suppose, now, that the directors of a corporation vote a dividend which is not payable out of the surplus profits, and, therefore, illegal and the stockholders receive their dividend checks, cash them and pocket the proceeds. Can the stockholders then on behalf of the corporation sue the directors to compel them to pay back the illegal dividend into the treasury of the corporation, or are the stockholders precluded from taking such action by the fact that they have lost this right by accepting the illegal dividends? Or, to use the legal expression, are they "estopped" from suing the directors?

This point has been frequently raised in the United States Courts, where it has been argued that the stockholders cannot sue, as it would be unjust for them to receive the money and get the benefit of it and then compel the directors to replace the very money which they had already received.

The better rule, however, is that the stockholders are in a position to sue and that, a proper case being made out, the directors can be compelled to refund the money. The argument that it would be unjust to allow the stockholders to compel the directors to repay the money which the stockholders themselves had received as dividends has been disposed of by the New Jersey Courts in the following words:—

"The argument assumes that there will be no transfer of the stock of the company during the period of the liability of the directors. The assumption is unwarranted. The very declaration of the dividend, evidencing, as it does, the prosperity of the corporation, creates a desire on the part of outsiders to become holders of the stock. It at the same time decreases the actual, while increasing the apparent value of the stock. The result is to afford unscrupulous directors, and stockholders who are cognizant of the illegal hold-

ings, an opportunity of unloading their stock upon innocent purchasers at fraudulently inflated prices."

In the same case the Courts points out that in many instances the stockholders have innocently accepted the illegal dividends and should not be precluded from taking action to protect themselves.

Nor is it inequitable that stockholders who have innocently participated in the distribution of the illegal dividends should have their stock restored to its normal value by contributions from the directors who have impaired the capital, without being first required to pay back the dividends so paid to them. The ordinary purchaser of corporate stock holds it as an investment. He rightly considers and treats the dividends paid upon it as income. In many instances the income is required to meet the expenses of living and is entirely expended for that purpose. To say that a person who has been unwittingly induced to exhaust his principal by the mistaken or fraudulent representations of those to whom he has intrusted it, that what has been paid to him as income suffers no injury is absurd. To refuse him redress except upon the condition that he return the moneys which he has expended in the belief that the capital was intact, notwithstanding that by such expenditure he is rendered peniless, is to put a premium upon fraud in corporate management."

The point has also been raised that while action can be brought to compel the directors to repay illegal dividends, the law is for the protection of creditors only, and the creditors may sue while the stockholders could not, but this argument has been answered by the California Court of Appeals in the following words:—

"Although one of the purposes of such a statute was to protect creditors, that was not its sole purpose. The statute affords protection in proper cases to the corporation, regardless of whether or not there are creditors. It would be nothing short of absurd, therefore, to hold that no suit could be maintained to enforce the liability, except one on behalf of the creditors."

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