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## RIGHTS OF PLEDGEEES OF STOCK TO VOTE AND RECEIVE DIVIDENDS

**S**HARES of stock are not infrequently in modern-day finance the subject of a pledge agreement. Aside from the ordinary rights that a pledgee may exercise to protect his interest upon a default in payment of the debt, questions often arise as to his right for the duration of the pledge agreement to exercise the special incidents of ownership that are characteristic of a share of stock. It can readily be seen that to whatever extent the pledgee is allowed to exercise these special rights, corporate stock becomes thereby more desirable for security purposes. The scope of this note will be limited to the pledgee's rights to receive dividends and to vote at corporate elections.<sup>1</sup>

### RIGHT TO DIVIDENDS

Generally, one taking stock as collateral security, in the absence of an express provision in the pledge agreement to the contrary, is entitled to receive dividends—whether of additional stock or of cash—that have accrued during the pledge.<sup>2</sup> The pledgee is

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<sup>1</sup> Other rights of shareholders as incidents of ownership with reference to which a similar inquiry might be made are the rights to enjoin ultra vires acts, to inspect corporate records, and to maintain a representative suit. This note has been limited because of the seemingly greater importance to the creditor of the topics chosen for consideration.

For recent excellent discussions of the shareholder's rights under consideration, see as to the right to receive dividends, *Hansen v. Bear Film Co.*, 158 P. (2d) 779 (Cal. App. 1945); *Rubens v. Marion-Washington Realty Corp.*, 59 N. E. (2d) 907 (Ind. App. 1945) (right to compel corporation to declare dividends in equity); 11 FLETCHER, CYCLOPEDIA OF CORPORATIONS (perm. ed. 1931) §§ 5321, 5451; 2 HILDEBRAND, TEXAS CORPORATIONS (1942) § 479. As to the right to vote and control the corporation, see *Blaustein v. Pan American Petroleum & Transportation Co.*, 263 App. Div. 97, 31 N. Y. S. (2d) 934 (1942); 5 FLETCHER, CYCLOPEDIA OF CORPORATIONS (perm. ed. 1931) §2027 *et seq.*; 2 HILDEBRAND, TEXAS CORPORATIONS (1942) § 545.

<sup>2</sup> *National Bank of Commerce v. Equitable Trust Co.*, 142 C. C. A. 158, 227 Fed. 526 (C. C. A. 8th, 1915); *Savings Union Bank & Trust Co. v. Crowley*, 176 Cal. 543, 169 Pac. 67 (1917); *Guarantee Co. of North America v. East Rome Town Co.*, 96 Ga. 511, 23 S. E. 503 (1895); *Fairbank v. Merchants National Bank*, 132 Ill. 120, 22 N. E. 524 (1889); *Whetsel v. Forgery*, 323 Mo. 681, 20 S. W. (2d) 523 (1929), Note (1930) 67 A. L. R. 476; *Mandel v. North Hudson Investment Co.*, 114 N. J. Eq. 336, 118 Atl. 432 (Ch. Div. 1933);

considered to be entitled to any increase or increment of the thing pledged which may be used for the purpose of liquidating the debt or held in trust for the pledgor. This right in the pledgee is held to arise by implication even though there has been no transfer upon the books of the corporation; and if the corporation after notice pays the dividends to the pledgor, it becomes liable in that amount to the pledgee.<sup>3</sup> The courts are even more strict where the dividend payments are in liquidation of corporate assets, for in those cases notice is not a prerequisite of liability. Under such circumstances, the corporation can protect itself by requiring that the stock certificate be presented before payment of the liquidating dividend.<sup>4</sup>

Many jurisdictions have passed legislation,<sup>5</sup> usually the Uniform Stock Transfer Act with or without modification, in an attempt to make the certificates as far as possible representative of the shares of which they are evidence.<sup>6</sup> Although the statement has been made by at least one court that the Act does not apply to a pledge of stock,<sup>7</sup> yet such a decision seems to disregard §3

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NOTES (1930) 67 A. L. R. 485, (1932) 30 MICH. L. REV. 974, (1933) 17 MINN. L. REV. 814, (1936) 103 A. L. R. 489. *Contra*: Reaves Warehouse Corp. v. Easley, 150 Va. 236, 142 S. E. 356 (1928).

<sup>3</sup>Garvey v. Blatchford Calf Meal Co., 119 F. (2d) 973 (C. C. A. 7th, 1941); *In re Decker's Estate*, 355 Pa. 331, 49 A. (2d) 714 (1947).

<sup>4</sup>Bay City Bank v. St. Louis Motor Sales Co., 255 Mich. 261, 238 N. W. 241 (1941).

<sup>5</sup>Alabama, Arizona, Arkansas, California, Colorado, Connecticut, Florida, Georgia, Idaho, Illinois, Indiana, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Missouri, Montana, Nebraska, New Hampshire (modified), New Jersey, New Mexico, New York, North Carolina, North Dakota, Ohio, Pennsylvania, Rhode Island, South Dakota, Tennessee, Texas, Utah, Virginia, Washington, West Virginia, and Wisconsin.

*Cf.* similar statutes in jurisdictions not adopting the act: IOWA COMP. CODE. (1946) § 491.50; KAN. GEN. STAT. (Corrick, 1935) § 17.604; MISS. ANN. CODE (Hemingway, 1917) § 4081; NEV. REV. LAWS (1912) § 1131; OKLA. STAT. ANN. (1936) Tit. 18, § 56; VT. GEN. LAWS. (1933) § 5844.

<sup>6</sup>Leff v. N. Kaufman's, Inc., 342 Pa. 342, 20 A. (2d) 786 (1941).

<sup>7</sup>Garvey v. Blatchford Calf Meal Co., 119 F. (2d) 973 (C. C. A. 7th, 1941); *First National Bank v. Wellborn*, 237 Ala. 183, 186 So. 549 (1939); *Bradsher v. Taylor*, 185 Ark. 1188, 46 S. W. (2d) 9 (1932). (The Uniform Act does not apply to a pledge of stock but only to sales and transfers of the title thereof).

(a)<sup>8</sup> which authorizes the corporation to treat the registered holder as the owner of the shares to receive dividends, inasmuch as the registered holder is often found to be in fact a pledgee. Under a strict construction of this section, if the pledgee wishes to protect his rights to dividends, it would be incumbent upon him to have the transfer noted upon the corporate ledger. The corporation would also be relieved of liability if it paid the dividends to the registered holder. Registration would serve as notice to all concerned, including the pledgor's attaching creditors, of the pledgee's interest.

It can be seen that a strict construction making registration upon the corporate books conclusive of the right to dividends is academic. The pledgor, who has made no express reservation of the dividends and under the common-law view would not be entitled thereto, could set up lack of registration by the pledgee as a defense to a suit against him for the dividends. Moreover, even though the corporation may have notice of the pledge agreement, it may through neglect or fraud fail to make the transfer upon the corporate records. Would the corporation thus be allowed to escape liability for its own acts constituting misconduct? For these reasons, courts of equity should look beyond the corporate records when it becomes necessary to do so to protect the pledgee's right to dividends.

#### RIGHT TO VOTE AT CORPORATE ELECTIONS

The value of corporate stock for purposes of pledged security becomes even greater when the pledgee is allowed to exercise the right to vote at corporate elections. The pledgee in this manner may obtain control of the corporation and is thus assured of added protection for his debt. However, under the guise of such an agreement, it is sometimes possible for an ulterior motive to

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<sup>8</sup> UNIFORM STOCK TRANSFER ACT § 3 in 6 UNIF. LAWS ANN. (1922) p. 9: "[CORPORATIONS NOT FORBIDDEN TO TREAT REGISTERED HOLDER AS OWNER]. Nothing in this act shall be construed as forbidding a corporation, (a) To recognize the exclusive right of a person registered on its books as the owner of shares to receive dividends, and to vote as such owner." See TEX. REV. CIV. STAT. (VERNON, 1925) art. 1358-3.

evade statutory prohibitions;<sup>9</sup> and insolvency of the corporation creates other factors which must be considered.<sup>10</sup> It then becomes incumbent upon the court to determine who shall vote the stock, the pledgor or pledgee?

Many of the modern authorities still adhere to the common-law rule that *prima facie* the right to vote at corporate elections is an incident of ownership and follows the legal title.<sup>11</sup> Under this rule the pledgee, whose interest is considered to be slightly greater than a mere possessory lien,<sup>12</sup> could not vote the stock. This right remains with the pledgor unless there is an express provision in the pledge agreement authorizing the pledgee to vote.<sup>13</sup> As long as the stock remains in the pledgor's name upon the corporation's books, it would seem that the corporation must allow him to vote, for it is generally held that registration on the corporate books is a condition of the right to vote which the election inspectors cannot waive.<sup>14</sup> But even though the stock is registered in the name of the pledgee and he appears as the legal owner, if the pledgor gives adequate notice he is entitled to vote as he has legal title in the final analysis. He may request that the pledgee give him a proxy to vote and, if necessary, may compel it by a suit in equity. But the courts have held that if the pledgor acquiesces at meetings of the corporation and makes no objection when his stock is voted, then the pledgor is "estopped" from claiming that the pledgee did not have authority to vote upon

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<sup>9</sup> *Thompson v. International Silver Co.*, 72 N. J. Eq. 224, 73 Atl. 833 (Ch. Div. 1907).

<sup>10</sup> *Cohen v. Big Stone Gap Iron Co.*, 111 Va. 468, 69 S. E. 359 (1910).

<sup>11</sup> *Drob v. National Memorial Park*, 41 A. (2d) 589 (Del. Ch., 1945); *Swain v. Martin*, 302 Ky. 381, 194 S. W. (2d) 855 (1946); see 5 FLETCHER, *CYCLOPEDIA OF CORPORATIONS* (perm. ed. 1931) § 2032.

<sup>12</sup> *State Trust and Savings Bank v. Mayes*, 67 S. W. (2d) 419 (Tex. Civ. App., 1934); *cf. Lawrence v. I. N. Parlier Estate Co.*, 15 Cal. (2d) 220, 100 P. (2d) 765 (1940).

<sup>13</sup> *Fisk Discount Corp. v. Brooklyn Taxicab Trans. Co.*, 270 App. Div. 491, 60 N. Y. S. (2d) 453 (1946).

<sup>14</sup> *In re Schrimmer's Will*, 231 App. Div. 625, 248 N. Y. S. 497 (1931). See 5 FLETCHER, *CYCLOPEDIA OF CORPORATIONS* (perm. ed. 1931) § 2019. *Contra: State v. Smith*, 15 Ore. 98, 14 Pac. 814 (1887).

corporate affairs. This extends to voting upon dissolution of the corporation as well as ordinary affairs.<sup>15</sup>

Practical necessity demands that the corporation have some means of determining who are its stockholders eligible to vote at elections and participate in management. To require the election inspector to inquire into the legal title of every share of stock prior to each election would impose upon him a difficult if not impossible task. For this reason the corporate by-laws should set forth a date prior to any election on which the record will be conclusive as to voting rights. Most states have adopted some statutory measure authorizing and approving such registration;<sup>16</sup> however, such a blanket regulation has been of little avail as a solution to the pledgor-pledgee problem. The provisions are usually too broad to cover all the conceivable situations involving pledge agreements, and it still remains a matter for the court to determine.

A few jurisdictions have enacted varying modifications of the Uniform Business Corporation Act,<sup>17</sup> which attempts to bring the pledgor-pledgee relation in line with rules governing voting in general by providing that the record holder shall be entitled to vote.<sup>18</sup> This Act, subject to the criticism of excessive generality, completely overlooks the pledge contract where the voting right has been either reserved or granted but the party entitled thereto is not registered upon the corporate books. Certainly the courts should not allow the registered pledgee to vote the stock in such a way as to defeat the very contract of pledge, nor should they

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<sup>15</sup>Carter v. Curlew Creamery Co., 16 W. (2d) 584, 134 P. (2d) 66 (1943).

<sup>16</sup>TEX. REV. CIV. STAT. (VERNON, 1925) arts. 1328, 1358-3. See THOMPSON ON CORPORATIONS (3rd ed. 1927) § 947.

<sup>17</sup>Idaho (modified), Illinois, Indiana (modified), Louisiana, Washington (modified).

<sup>18</sup>MODEL BUSINESS CORPORATIONS ACT § 28-V in 9 UNIF. LAWS ANN. (1942) p. 119: "A person whose shares are pledged shall be entitled to vote thereon until said shares have been transferred on the books of the corporation to the pledgee, and thereafter the pledgee shall be entitled to vote the same. . . ."

allow the pledgor to vote the stock so as to prejudice the rights of the pledgee.<sup>19</sup>

The right to vote is secured to the pledgor in many states by statute.<sup>20</sup> Such legislation would serve to settle any question where the pledge agreement is silent upon this issue, but many of these statutes are absolute in their language<sup>21</sup> and thus seemingly inconsistent with the modern trend. There seems to be no valid reason, other than the equitable considerations pointed out earlier, why the intention of the parties as expressed in the pledge agreement should not be enforced. The more strict statutes overlook the important power of the parties to contract in regard to these property rights. The courts in the past have looked beyond the contract to determine the rights and equities of all the parties concerned, and there is no reason to believe that this procedure will not continue despite such existing statutes.<sup>22</sup>

Statutory provisions have not been wholly without benefit to those in the pledgor-pledgee relation. The provision for registration affords a means for the pledgee to ascertain the true ownership of the stock prior to entering into the pledge agreement. By registering the stock in his name, he removes any question as to the consummation of the pledge contract; and in some jurisdictions such registration serves to protect him from the pledgor's creditors.<sup>23</sup> The fact cannot be overlooked that the requirement serves as a form of notice to the corporation, relieves it from

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<sup>19</sup>*Id.*, § 28-VII: "Shares of a corporation belonging to said corporation shall not be voted nor counted in calculating the total voting power of all shareholders of such corporation at any time." The Commissioners on Uniform Laws anticipated a liberal interpretation of § 28-V and proposed this section to limit its scope. It substantially follows the common-law rule on this point.

<sup>20</sup>MO. REV. STAT. (1939) § 5351; TEX. REV. CIV. STAT. (Vernon, 1925) art. 504.

<sup>21</sup>ARIZ. CODE (1939) § 53.210.

<sup>22</sup>*In re Schrimmer's Will*, 231 App. Div. 625, 248 N. Y. S. 497 (1931).

<sup>23</sup>*Selma Bridge Co. v. Harris*, 132 Ala. 179, 31 So. 508 (1902); *Maloney v. Strojo-hann*, 206 Iowa 721, 221 N. W. 208 (1928), followed in *Maloney v. Hampe*, 221 N. W. 526 (1928); *cf. Lawrence v. I. N. Parlier Estate Co.*, 15 Cal. (2d) 220, 100 P. (2d) 765 (1940); *McGhie v. First & Amer. Nat. Bank*, 217 Minn. 325, 14 N. W. (2d) 436 (1944); *Tombler v. Palestine Ice Co.*, 17 Tex. Civ. App. 596, 43 S. W. 896 (1897).

certain potential liability in the payment of dividends, and facilitates the determination of the stockholders who are eligible to vote at corporate elections.

In view of the extent to which wealth in modern economic society is represented by corporate stock, legislation should be enacted whenever necessary to increase the attractiveness of this important source of collateral security. To allow the pledgee to exercise the right to receive dividends and vote gives him added security and renders the stock more desirable for this purpose. The Uniform Business Corporations Act, although not completely satisfactory, would seem a step toward the desired result.

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