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Elimination of Preemptive Rights in a Wyoming Corporation

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The trustee performed no acts which would bear the same relationship to the agreement as the solicitation of insurance in the *McGee* case. Florida had no "manifest interest" in providing redress for its citizens under these circumstances. (The Court cited the police power cases.) The application of the substantial connection rule "will vary with the quality and nature of the defendants activity. It is essential that there be some act by which the defendant purposefully avails himself of the privilege of conducting activities within the state."

All of the ramifications of the *McGee* doctrine have not been evolved. However, a logical conclusion appears that the Supreme Court has discarded the traditional tests for state jurisdiction in an attempt to establish a doctrine which can be applied to the various circumstances which arise in our expanding national economy and interstate business. The *McGee* doctrine is very general so that it may be applied under a variety of circumstances. Yet, as illustrated by *Hanson v. Denckla*,²³ it contains language which may limit its application in other situations where the demands of due process so require.

BOB R. BULLOCK

ELIMINATION OF PREEMPTIVE RIGHTS IN A WYOMING CORPORATION

Under the common-law doctrine of preemptive rights, shareholders have a right or option to subscribe for newly authorized issues of shares before they are offered to the public. This right allows the shareholders to subscribe to the newly authorized issue of shares in proportion to their present holdings, and it is intended to safeguard the shareholders against unfairness and dilution of their interest and voting power. The right has been made subject to various exceptions on grounds of practical convenience.

Ballantine claims the right aims to safeguard shareholders against unfairness in the issues of shares, particularly against two possible wrongs:¹

(1) the manipulation of voting control of the corporation by the issue of shares to some one shareholder or group to the exclusion of others, and

(2) the issue of shares at an inadequate price to favored persons, thereby diluting the proportionate interest of other shareholders.

The various exceptions based on grounds of practical convenience as recognized by some courts are shares previously authorized, as distinguished

23. *Ibid.*

1. Ballantine, *Corporations*, P. 487 (rev. ed. 1946).

from shares newly authorized,² treasury shares,³ shares for which it is proposed that the corporation receive consideration other than cash,⁴ shares used to satisfy conversion or option rights granted by the corporation,⁵ and shares used to effect a merger or consolidation.⁶

The one instance in which the preemptive right is almost universally recognized is in an issue of newly authorized stock which is being sold for cash.⁷ But, even under these circumstances, non-recognition may be desirable. Modern corporations must have the ability to raise large sums on short notice in order to successfully carry out expansion programs. The directors cannot float large issues on favorable terms if their freedom of action is hampered by the presence of the preemptive right.⁸ For example, consider the failure of a Pure Oil Company stock issue brought about by the delay and uncertainty necessarily incident to the exercise of the preemptive right on the part of stockholders.⁹ And consider, *Verner v. American Telephone and Telegraph Company*,¹⁰ involving an underwriting, where the court stated:

When to the time needed for permitting the exercise of the preemptive right must be added the twenty day "cooling period" required by the Securities Act of 1933 (15 U.S.C.A. § 77h), the magnitude of the problem is increased proportionately.

Directors will simply be prevented from securing and underwriting on favorable terms, especially during periods of market fluctuations, because the underwriters will hesitate to contract when the preemptive right must be recognized.

Another instance in which recognition of the preemptive right may defeat the exercise of a desirable plan is in the case of stock options. A corporation may wish to grant valuable employees an option to purchase stock. The usual purpose for making such an offer is to induce these valuable employees to remain in the employ of the corporation. Otherwise, these employees may leave for higher salaries offered by competing corporations.

To justify recognition of the doctrine of preemptive rights, the rule must be flexible so as to meet modern day needs of corporations. There was no need for flexibility in the period in which the doctrine of pre-

2. *Dunlay v. Avenue M Garage & Repair Co.*, 253 N.Y. 274, 170 N.E. 917 (1930).

3. *Borg v. International Silver Co.*, 11 F.2d 143 (S.D.N.Y. 1926).

4. *Milwaukee Sanitarium v. Swift*, 238 Wis. 628, 300 N.W. 760 (1941).

5. *Venner v. American Telegraph & Telephone Co.*, 100 Misc. 118, 181 N.Y.Supp. 45 (Sup.Ct. 1920), *aff'd*, 196 App.Div. 960, 188 N.Y.Supp. 956 (1st Dept. 1921).

6. *Thom v. Baltimore Trust Co.*, 158 Md. 352, 148 Atl. 234 (1930).

7. *Stevens, Corporations*, § 111 (2d ed. 1949).

8. See Note 65, *Harv. L. Rev.* 507, 508 (1951).

9. *The Investment Banker*, 1939, *Fortune Mag.*, Sept. 1939, 78, at 110; *N.Y. Times*, Aug. 24, 1937, p. 36, col. 1, Sept. 7, 1937, p. 52, col. 2, Sept. 28, 1937, p. 38, col. 4, Oct. 23, 1937, p. 27, col. 8 Dec. 8, 1937, p. 42, col. 2 (tracing the failure of a Pure Oil Co. stock issue because of the existence of preemptive rights).

10. *Supra* note 5.

emptive rights arose in the United States. The first American case invoking the doctrine was *Gray v. Portland Bank*.¹¹ In that case, the doctrine was capable of rational application because the corporation had only one class of stock. Where there is but one class of stock, the extent which present shareholders' interests would be affected in a new issue if offered to outsiders is obvious. With the utilization of complex capital structures now in vogue, the extent of the right is difficult to define.

Aside from this problem of time, there are other difficulties raised by the preemptive right. Mr. Frey has illustrated the problem presented by the great number of combinations possible with three or four classes of preferred shares, some voting, some not, some convertible into one class of securities, others into another, some redeemable at one rate, others at another, with different rates of preferred dividends, and different rights to participate in surplus earnings; after that classes of lettered common shares, of par and of no par value and with all sorts of ingenious attributes; and finally with bonds or debentures convertible on various contingencies into still different classes of shares.¹² An issue under one of these combinations will necessarily affect the interests of shareholders of another class. For example, consider *Russell v. American Gas & Elec. Co.*¹³ A shareholder of non-participating preferred stock sought to enjoin an issue of new common to the holders of common exclusively. The shareholder's bill was dismissed, but it was dismissed only on the condition that new preferred be issued to the complainant sufficient to preserve his proportionate interest. Such a solution, although theoretically possible, is impractical because underwriters will not be willing to underwrite such an issue.

Many states have recognized the need for flexibility and attempt to provide for it by statute. For example, Delaware¹⁴ and New York¹⁵ provide that the preemptive right shall exist unless limited or denied by the corporate charter; California¹⁶ provides that the preemptive right shall not exist unless it is expressly provided for in the charter; Michigan¹⁷ provides that the preemptive right may exist if provided for in the articles; Pennsylvania¹⁸ codifies the preemptive right; New Jersey¹⁹ provides it may be abolished only by two-thirds vote of each class of stockholders in interest and Maryland²⁰ provides the preemptive right may be "defined, limited or denied."

Unfortunately, there is no mention of preemptive right in Wyoming

11. 3 Mass. 364 (1807).

12. Frey, Shareholders' Pre-emptive Rights, 38 Yale L.J. 563, 566 (1929).

13. 152 App.Div. 136, 136 N.Y.Supp. 602 (1912).

14. Del. Code Ann. tit. 8, § 157 (1953).

15. N.Y. Stock Corp. Law § 39 (1941).

16. Cal. Corp. Code § 1106 (1955).

17. Mich. Stat. Ann. § 21.31 (Supp. 1955).

18. Pa. Stat. Ann. tit. 15, § 137 (1938).

19. Rev. Stat. of N.J., Vol. 1, 14:8-17 (1937).

20. Md. Ann. Code art. 23, § 26 (1951).

statutes.²¹ Consideration of a few cases from other jurisdictions may provide some guidance as to whether the preemptive right could be eliminated in a Wyoming corporation.

The obvious method for eliminating the right is to do so by charter provision. The only direct authority is an early Indiana case.²² The charter of the corporation provided that the directors shall have the power to increase the stock of said company to a given limit, on such terms and conditions, and in such manner, as to them shall deem best. It provided further that the existing stockholders shall have no exclusive right to take the increased stock in amounts proportionate to the several amounts of the original stock held by them. This provision was inserted in the charter in the absence of Indiana statute specifically authorizing such a provision. Even in the absence of statute, the court gave effect to the provision. Prof. O'Neal, in his article on *Molding the Corporate Form*,²³ states that most courts could give effect to such an optional charter provision even in the absence of statute.

But, Prof. O'Neal further points out that Wyoming is a state which has no statutory authorization for the use of optional charter provisions, and he continues on to say that in the absence of statutory authorization it is doubtful whether inserted optional provisions would be given effect if challenged. The reason is that the specific enumeration by the statute of the contents of the charter necessarily implies the exclusion of other items.²⁴ It therefore seems doubtful that such an optional charter provision permitting elimination of preemptive rights would be recognized in Wyoming.²⁵

The preemptive right could not be eliminated by amendment of the articles of incorporation even if such a charter provision would be valid if originally included. A Wyoming corporation has no general amending power, and the preemptive right could not therefore be eliminated by charter amendment. The same result might be achieved, however, by organizing a new Wyoming corporation and merging the old into the new, thereby acquiring the desired original charter provision. This method of eliminating preemptive rights in Wyoming corporations would be supported by a Maryland case²⁶ in which a shareholder's preemptive right was cut off in a consolidation. In the new corporation, there was no provision for recognition of the preemptive right. The court stated that the consolidation of the old corporations ended their existence and vested their

21. Wyo. Rev. Stat. Ann. 28-125 (1931) provided that holders of common stock should have the first opportunity to purchase newly issued preferred stock in proportion to their holdings of common stock. That section 28-125, Revised Statutes of Wyoming, 1931, was repealed. [L. '39, ch. 62, §9]. Effective February 17, 1939.

22. *Ohio Ins. Co. v. Nunnemacher*, 15 Ind. 294 (1860).

23. O'Neal, *Molding the Corporate Form to Particular Business Situations: Optional Charter Clauses*, 10 *Vanderbilt L. Rev.* 1 (1957).

24. *Oregon Ry. & Nav. Co. v. Oregonian Ry.*, 130 U.S. 1, 9 S.Ct. 409, 32 L.Ed. 837 (1888).

25. Wyo. Comp. Stat. § 44-101 (1945) is an enumerative type statute.

26. *Thom v. Baltimore Trust Co.*, 158 Md. 253, 148 Atl. 234 (1930).

property and powers in the new corporation; and where the shareholder's right to purchase a proportion of a new issue of stock could be traced to the charter of only one of the consolidated corporations, or was subject in one to a special limitation, it did not survive the consolidation.

A similar Delaware case²⁷ held that under the general amending power granted by statute, the preemptive right is not a "vested" right and thus may be terminated by amendment of the certificate of incorporation. The court construed the wording of the Delaware statute which authorized changing "other special rights" of the shares as authority to terminate the preemptive right by amendment. A New York case,²⁸ however, allowed the amendment eliminating the preemptive right only as to the shareholders who voted for the amendment. The court said that the amendment could not bind a shareholder who opposed its adoption. It would seem at least possible that the New York rule might be extended to protect shareholders who dissent from the merger proposed as a device for eliminating preemptive rights, and it therefore raises serious doubts as to the effectiveness of that method.

The only reasonably safe method for securing an elimination is therefore a rather drastic one: a Wyoming corporation could probably reorganize in another state and eliminate the preemptive right without risk of liability to shareholders later asserting a preemptive right based on the provisions of the defunct Wyoming charter.

Recent legislation²⁹ of various states indicate that their legislators recognized the desirability of providing statutory authority for flexibility in the recognition of the preemptive right. Writers³⁰ and judges³¹ have encouraged the trend. It is submitted that the protection which the preemptive right allegedly affords is adequately afforded by the directors in exercising their fiduciary duty not to use their positions for their own personal advantage, or to discriminate between shareholders, or to cause stock to be issued so as to make a profit for themselves or to obtain control of the corporation. When this duty is exercised, the advantages to the corporation will redound to the shareholders as a whole, and will offset any theoretical detriment resulting from the dilution of their voting strength in an issue of stock for its fair value.

Wyoming legislators should follow the course of the legislators of other states who have enacted appropriate legislation dealing with the

27. *Gottlieb v. Heyden Chemical Corp.*, 32 D.Ch. 23, 83 A.2d 595 (1951) rev'd on other grounds.

28. *Albrecht, Maguire & Co. v. General Plastic Inc.*, 256 App. Div. 134, 9 N.Y.Supp.2d 415 (4th Dept. 1939), aff'd without opinion, 280 N.Y. 840, 21 N.E.2d 887 (1939).

29. See notes 14 through 22 *supra*.

30. *Drinker, The Pre-emptive Right of Shareholders to Subscribe to New Shares*, 43 *Harv. L. Rev.* 586 (1930).

31. *Yoakam v. Providence Biltmore Hotel Co.*, 34 F.2d 533, 538-539 (D.R.I. 1929).

preemptive right. The Model Business Corporation Act § 24 on Shareholders' Preemptive Rights may well serve as their guide.³²

JERRY M. MURRAY

A REVIEW OF PRESENT LAW ON THE ADMISSION OF ILLEGALLY OBTAINED EVIDENCE IN OUR STATE AND FEDERAL COURTS

I. INTRODUCTION

There exists today, among state and federal courts, a divergence of opinion as to the admissibility of evidence illegally¹ obtained by state and federal officials.

Illegally obtained evidence which is admissible in certain state courts is inadmissible in others, and in our federal courts. Yet, evidence which is inadmissible in a state court sometimes may be admissible in a federal prosecution. The object of this article is to review the status of the law as it now stands.

II. ADMISSIBILITY IN FEDERAL COURTS OF EVIDENCE ILLEGALLY OBTAINED BY FEDERAL OFFICERS

It is a well-settled general rule today that evidence illegally obtained by federal officers is inadmissible in the federal courts.² This so-called "Exclusionary Rule" excludes any evidence obtained by unlawful search, and also the oral evidence concerning what was found or seized while the unlawful search was being conducted, together with the evidence developed as a result.

There are different theoretical bases for the exclusion in federal courts of illegally obtained evidence. Some courts appear to rely directly on the Fourth Amendment to the Constitution.³ Other courts take the position

32. Model Business Corporation Act, American Law Institute § 24 (1953). "The preemptive right of a shareholder to acquire unissued or treasury shares of a corporation may be limited or denied to the extent provided in the articles of incorporation.

Unless otherwise provided by its articles of incorporation, any corporation may issue and sell its shares to its officers or employees or to the officers or employees of any subsidiary corporation without first offering such shares to its shareholders, for such consideration and upon such terms and conditions as shall be approved by the holders of two-thirds of all shares entitled to vote thereon or by its board of directors pursuant to like approval of the shareholders." See also, § 53, clause p, for the right to amend articles to "limit, deny, or grant" preemptive rights.

1. "Illegal" is used in this article to include any act prohibited by the federal or state constitutions or any state or federal statutes.

2. *Boyd v. United States*, 116 U.S. 616, 6 S.Ct. 524, 29 L.Ed. 746 (1888); *Ex parte Jackson*, 96 U.S. 727, 24 L.Ed. 877 (1877); *Weeks v. United States*, 232 U.S. 383, 34 S.Ct. 341, 58 L.Ed. 652 (1914).

3. *United States v. Jeffers*, 342 U.S. 48, 72 S.Ct. 93, 96 L.Ed. 59 (1951); a review of the history of the Fourth Amendment will show that the founders of our nation felt very strongly about the English practice of searching by writs of assistance. For a discussion of the history of the Fourth Amendment, see *Boyd v. United States*, supra note 2.