

# STOCK-PURCHASE PLANS

By EMILIANO R. NAVARRO \*

The authority of a corporation to adopt employee stock-purchase plans is generally conceded independently of statute.<sup>1</sup> Little known before the turn of the present century, stock-purchase plans came to be widely adopted after the first World War.<sup>2</sup> By 1928, more than \$1,000,000,000 in stockholdings was reported to be in the hands of employees in the United States.<sup>3</sup> The practice has attracted the attention of economists early in the present century and literature on the subject, obviously non-legal, is not wanting.<sup>4</sup> Purchase plans were adopted antedating statutory regulations.<sup>5</sup>

The most usual reason given for the plan is that of inducing loyalty in the employee to the corporate enterprise adopting it.<sup>6</sup> Other reasons are (1) to encourage the habit of thrift in employees,<sup>7</sup>

---

\* LL.B. (U.P.); LL.M. (University of Michigan). Fellow of the University of the Philippines, University of Michigan, and the U.S. State Department, 1949-1950.

<sup>1</sup> Assertions to this effect are to be found among writers. "Certainly positive statutory authority is not essential . . ." Fordham, "Some Legal Aspects of Employee Stock-Purchase Plans," 8 *North Carolina Law Review*, 161, 163. See also comment in 21 *California Law Review*, 358, note 4. This much seems x x x implied from the discussion in 19 Fletcher, *Cyclopedia of Corporations*, Permanent edition, sec. 8906. See also *Harker v. Ralston Purina Co.*, 45 Fed. (2d) 929, 930.

<sup>2</sup> "A few American employee stock ownership plans were established before 1900. The oldest known plan in the United States was introduced by the A. W. Burritt Company, lumber manufacturers of Bridgeport, Connecticut, who began to sell stock to its executives in 1893 and in 1917 extended to all employees the right to subscribe." Stewart and Couper, *Profit Sharing and Stock Ownership*, 1945, p. 56.

<sup>3</sup> The National Industrial Conference Board, Inc., *Employee Stock-Purchase Plans in the United States*, 1928 pp. 39-40. See also Foerster, "Employee Stock Ownership," 5 *Encyclopedia of the Social Sciences*. It is suggested that the figures could have been greater. See comment in 21 *California Law Review*, 358, note 1.

<sup>4</sup> See bibliography in Appendix B of Stewart and Couper, *supra*, p. 107 et seq; Thompson, "Selected Bibliography, Employee Stock Ownership in the United States," *Monthly Labor Review of the Bureau of Labor Statistics of the U. S. Dept. of Labor*, June, 1927.

<sup>5</sup> Foerster and Dietel, *Employee Stock Ownership in the United States*, 1927, pp. 6-8.

<sup>6</sup> 19 Fletcher, *op. cit.*, *supra*, p. 61; comment in 21 *California Law Review*, 358; Ballantine, Sterling and Buhler, *California Corporation Laws*, 1949, p. 144; Fordham, *op. cit.*, *supra*, at p. 162. "The natural tendency of such interest was to increase the zeal of the employee and thus to forward the chances of success in the corporation's legitimate operations." *Harker v. Ralston Purina Co.*, *op. cit.*, *supra*. See also Stewart and Couper, *op. cit.*, *supra*, p. 109.

<sup>7</sup> Stewart and Couper, *supra*, p. 61; The National Industrial Conference Board, Inc., *Practical Experience with Profit Sharing in Industrial Establishments*, 1920, pp. 41-45.

(2) to reward faithful employees,<sup>8</sup> (3) to tap a source of ready capital,<sup>9</sup> (4) to minimize the unequal distribution of wealth and the evils of absentee ownership,<sup>10</sup> (5) to give the employees a share in management,<sup>11</sup> and (6) to give the employees a source of income and make them independent.<sup>12</sup> A minority of managements hope that stock ownership would make membership in unions less attractive.<sup>13</sup> Apparently because of this labor leaders have opposed vigorously stock-purchase plans as well as any looking towards profit sharing. These are generally regarded as calculated by management to alienate the affection of employees for unionization.<sup>14</sup> But in case management uses the stock-purchase plan to frustrate or to interfere with the formation of a labor union, the courts will declare it an unfair labor practice, as it was so declared under the National Labor Relations Act of 1935. And where the plan binds the employees to refrain from requesting a raise in wages, it would be declared null and void.<sup>15</sup> Because of this holding, labor opposition to employee stock ownership is pretty much deprived of basis. Apart from this objection, however, the disadvantages of employee

<sup>8</sup> The National Industrial Conference Board, Inc., *supra*, pp. 41-45.

<sup>9</sup> Fordham, *op. cit.*, *supra*, p. 162; Stewart and Couper, *op. cit.*, *supra*, Appendix B, p. 113, citing Bruere and Pugh, *Profitable Personnel Practice*, 1929.

<sup>10</sup> "Profit Sharing for Executives and Employees—The American Tobacco Company, A Case In Point," 42 *Yale Law Journal*, 419. "To optimists the democratization of industry through employee stock ownership seems to point toward the reduction of obvious inequalities and the strengthening of the strong points of our present social organization rather than toward any far-reaching changes in the social order." Stewart and Couper, *supra*, Appendix B, p. 113, citing James et al., *Profit Sharing and Stock Ownership for Employees*, 1926.

<sup>11</sup> Fordham, *op. cit.*, *supra*, p. 162. "Proponents of employee stock ownership hold that it will lead to more conservative and stable management. Critics argue that no management can be enterprising if many persons of small means are stockholders and that in such circumstances control of the corporation probably would be in the hands of a few." Stewart and Couper, *supra*, Appendix B, p. 112, citing Foerster and Dietel. *Employee Stock Ownership in the United States*, 1926.

<sup>12</sup> Fordham, *op. cit.*, *supra*, 162. "Employee stock ownership tends to diminish the dependence of the worker upon his current wages by providing a reserve of property and secondary income and so may exercise a correct influence upon the asperities of the capitalistic system." Stewart and Couper, *supra*, Appendix B, p. 112. A reason advanced for profit sharing is equally relevant to stock ownership. "Some companies consider profit sharing a valuable medium for convincing workers of the virtues of capitalism. Profit sharing, they believe, will be a bulwark against the spread of communism." Brower, *Profit Sharing For Workers*, 1948, p. 8, *Studies in Personnel Policy*, No. 97, The National Industrial Conference Board, Inc.

<sup>13</sup> Stewart and Couper, *supra*, p. 61.

<sup>14</sup> See comments in 42 *Yale Law Journal*, 419, 420, note 5; Fordham, *op. cit.*, *supra*, p. 162, notes 7 and 8; Brower, *op. cit.*, *supra*, pp. 3-4.

<sup>15</sup> National Labor Relations Board v. Vincennes Steel Corp., 117 Fed. (2d) 169, 172-173.

stock ownership are quite numerous.<sup>16</sup> But while the adoption of the plan is in the main a problem of business management and that it may be used, under some circumstances, with fruitful results both to the employees and management, it seems wise to provide by legislation some regulatory measures.

---

<sup>16</sup> It seems to be generally accepted that the plan works best during times of prosperity when wages are high and employment wide and that it works the other way in times of recession. Thompson, *Profit Sharing*, 1949, p. 11. \* \* \* "Researches on the subject after the stock market crash in 1929 are in the nature of post mortems. A French observer expressed contempt that American corporations were so unsophisticated as to encourage their employes to invest in common stocks. He disparaged the significance of the emergence of worker capitalism and the possibility of continuous prosperity, questioned management's motives in establishing stock ownership plans and blamed the employers of this country for doing harm to the whole international economy. Other studies, searching among the ashes of the movement, estimated the number of employees under the defunct plans and their holdings and losses, and dwelt on the almost complete collapse of this much proclaimed instrument of industrial democracy, the embarrassment of the corporations that had learned a lesson the hard way, and the disillusionment and bitterness of workers who had lost their savings and their jobs.

"The more recent studies tend to dismiss employee stock ownership as inappropriate for wage earners and to consider it mainly as a phase of the larger problem of executive compensation. A number of considerations are pointed to as casting doubt on the desirability of stock bonuses and stock options for executives in the social climate of the times. They stress such difficulties as the drawing of the veil of secrecy on executive compensation, serious corporate and income tax problems, the doubtful merit of such measures as an incentive device, the ill will they create in a period of declining stock prices, their possible encroachment on the interests of shareholders and the possibility of more litigation than in the past, the downward revision of executive compensation that has resulted from some cases, the danger of further government intervention if bad practice is not discontinued, and the need of a higher sense of social responsibility in these matters on the part of management." Stewart and Souper, *op. cit.*, *supra*, pp. 66-67.

Another author has this to say: "With the collapse of stock market values in 1929 the dangers and disadvantages of employee stock ownership plans became readily apparent. Employee income from dividends was curtailed at the very time that wages and employment declined. The value of stock holdings telescoped and employees found that their savings had shrunk to a fraction of stock purchase price. With principal endangered and dividends omitted, workers, not understanding the impersonal causes of their misfortune, frequently blamed their employers.

"Most workers can accumulate only small savings and the risk of investing the entire amount in securities of their company without diversification safeguards is too great. Even the normal fluctuation of stock values creates insecurity as to the safety of funds invested. Encouragement of speculation in other securities rather than of thrift has sometimes resulted from the employee stock owning experience.

"Stock ownership shifts employee attention to external market events. The relation of the individual worker to stock values and dividend returns is so remote that any connection with job performance seems coincidental. Common stock is a speculative investment and, while its ownership may confer a sense of belonging, it frustrates the desire for financial security which is especially strong for those with small incomes." Thompson, *Profit Sharing*, 1949, pp. 167-168.

Ten states of the American Union were reported in 1933 to have laws on employee stock ownership. Two more joined since then. California,<sup>17</sup> Colorado,<sup>18</sup> Idaho,<sup>19</sup> Illinois,<sup>20</sup> Louisiana,<sup>21</sup> Michigan,<sup>22</sup>

<sup>17</sup> Sec. 1107 provides: "A corporation may, upon such terms and conditions as the articles or by-laws may authorize, provide and carry out an employee stock purchase plan for the issue and sale of its unissued shares, or of issued shares purchased, or to be purchased or acquired, to the employees of the corporation or to the employees of subsidiary corporations or to a trustee on their behalf, and for the payment of such shares in installments or at one time, and for such consideration as may be fixed, and may provide for aiding any such employees in paying for such shares by compensation for services or otherwise."

Sec. 1108 provides: "An employee stock purchase plan may include, among other features, the fixing of eligibility for participation therein, the class and price of shares to be issued or sold under the plan, the number of shares which may be subscribed for, the method of payment therefore, the reservation of title until full payment, the effect of the termination of employment, an option or obligation on the part of the corporation to repurchase the shares upon termination of the employment, restrictions upon the transfer of the shares, the time limits, and termination of the plan.

"Any shares subject to preemptive rights under the articles may be issued and sold under the plan without prior offering to shareholders entitled to preemptive rights, but only with the written consent or vote of the holders of two-thirds of the shares entitled to exercise the preemptive rights." California Corporation Code.

<sup>18</sup> Sec. 40 provides: "That any corporation organized under the laws of this State may, upon such terms and conditions as may be determined in the manner hereinafter designated, provide for and carry into execution a plan or plans for any or all of the following purposes:

"(a) The issue and sale, or purchase and sale, of its capital stock, whether authorized or hereafter authorized, to any or all of its employees, including officers and directors and those actively engaged in the conduct of the business of such corporation or of any subsidiary thereof or of any corporation or association in which, or in the welfare of which, such corporation shall have an interest, or to a trustee or trustees for their benefit, upon such terms and conditions as may be determined by the board of directors and incorporated in such plan or plans, including, but without limiting the generality of the foregoing, and the payment for such stock in installments or at one time, with or without the right to vote thereon pending payment therefor in full, and for aiding or assisting any such employees and said other persons in paying for services, or otherwise. All sums expended in the formulation, adoption and carrying out of any such plan and the cost of any such aid shall be regarded as part of the corporation's legitimate expenses . . ."

Sec. 41 provides: "Any of the privileges and powers granted pursuant to the provisions of Subdivisions (a) . . . of Section (40) hereof may be exercised either by including appropriate clauses therefor in the original articles of incorporation or by-laws at the time of organizing the corporation, or where the corporation has been formed without said charter or by-law provisions, the board of directors shall first formulate such plan or plans and pass a resolution declaring that in its opinion the adoption thereof is advisable, and shall submit such plan to the stockholders entitled to vote thereon at any annual or special meeting of such stockholders, who shall take action thereon at said meeting. Notice of the time, place and purpose of such meeting shall be given as by law and the by-laws required for the holding of annual or special meetings of stockholders, as the case may be. If the holders of a majority of the stock represented at such meeting and entitled to vote shall vote in favor of any

such plan, said plan shall thereupon become operative as of such date as may be fixed and determined by the board of directors.

Sec. 42 provides: "In the case of a corporation whose stockholders have, under the provisions of its articles of incorporation, a preemptive right to subscribe for any stock to be issued or sold, any stockholder represented, either in person or by proxy, at any such meeting held for the purpose, among others, of taking action on a plan formulated pursuant to the provisions of Subdivision (a) of Section (40) hereof, and voting in favor of such plan, or being present or represented at said meeting and failing to vote, and each and every stockholder who fails to attend said meeting either in person or by proxy, shall be conclusively deemed to have assented to such plan, and to have waived any preemptive right to subscribe for any stock to be issued or sold under said plan. Any stockholder of any such corporation whose stockholders have such preemptive right, attending said meeting, either in person or by proxy and voting against such plan or plans, may within thirty days from the date of said stockholders' meeting serve a demand in writing upon the secretary of said corporation for the right to purchase his pro rata share of any new stock to be issued under said plan at the price therein provided for, but if such demand is not made in writing, as aforesaid, within thirty days after the holding of such stockholders' meeting, any preemptive right of such dissenting stockholder to any stock issued or to be issued, sold or to be sold, under said plan, shall be forever barred."

Sec. 43 provides: "Any plan adopted as aforesaid may be recalled, abolished, amended, altered or changed in the same manner as hereinbefore provided for its adoption, but if any such plan is recalled or abolished after the same has been declared operative, the corporation shall refund any moneys contributed by employees, officers, directors, or those actively engaged in the conduct of the business of such corporation or of any subsidiary thereof or of any corporation or association in which, or in the welfare of which, such corporation shall have interest, and for which no stock or other equivalent has been issued or paid." Colorado Statutes Annotated, 1935, ch. 41.

<sup>19</sup> Sec. 30-120 provides: "Unless otherwise provided in the articles shares shall not be subject to such preemptive rights if,

"a. Allotted for sale to employees under subdivision 7 of this Section; . . .

"7. A corporation may upon such terms and restrictions as it may impose, provide and carry out a plan for the allotment and sale of any or all of its unissued shares or of shares purchased or to be purchased or acquired, to the employees of the corporation or of subsidiary corporations or to a trustee in their behalf, and for the payment of such shares in installments or at one time, and for the establishment of a special fund or funds in which such employees during the period of their employment or other period of time may be privileged to share on such terms and conditions as may be imposed in respect thereof; provided, that shares otherwise subject to preemptive rights under the provisions of the preceding Section may be allotted and sold under such plan free from such preemptive rights only with the written consent or vote of the holders of a majority of the shares entitled to exercise preemptive rights with respect thereto." Idaho Code, Tit. 30.

<sup>20</sup> Sec. 24 provides: "The preemptive right of a shareholder to acquire additional 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 employees or to the employees of any subsidiary corporation, without first offering the same to its shareholders, for such consideration and upon terms and conditions as shall be approved by the holders of two-thirds of its board of directors pursuant to like approval of the shareholders." The Business Corporation Act.

New Jersey,<sup>23</sup> New Mexico,<sup>24</sup> New York,<sup>25</sup> Ohio,<sup>26</sup> Oklahoma,<sup>27</sup> and Pennsylvania<sup>28</sup> have legislated on the subject. England, under the

<sup>21</sup> Sec. 1103 provides: "Unless the articles otherwise provide, a corporation may purchase its own shares of any class issued by it, but only out of surplus available for dividends, and only if such purchase does not violate the contractual right of any other class of shares;

"(c) When the purchase is for the purpose of resale or allotment to employees under the provisions of section 28 of this act; or

"(d) When the purchase is to effect repurchase from an employee who has purchased such shares from the corporation under an agreement reserving to the corporation the right to repurchase, or obligating it to repurchase such shares."

Sec. 1108 provides: "(c) A corporation may, upon such terms and restrictions as it may impose, provide and carry out a plan for the allotment and sale of any or all of its unissued shares, or of shares purchased or to be purchased to the employees of the corporation, or to the employees of subsidiary corporations, or to a trustee on their behalf, and for the payment for such shares in installments, or at one time, and for the establishment of a special fund or funds in which such employees during the period of their employment, or other period of time, may be privileged to share on such terms and conditions as may be imposed in respect thereof; provided, that shares otherwise subject to preemptive rights under the provisions of subparagraph (a) may be allotted and sold under such plan free from such preemptive rights only with the written consent or vote of the holders of a majority of shares entitled to exercise preemptive rights with respect thereto." Business Corporation Act, General Statutes, 1939.

<sup>22</sup> Sec. 450.24 provides: "A corporation formed or existing under this act may, upon terms and restrictions as it may impose, provide and carry out a plan for the allotment and sale of any or all of its unissued shares or of shares purchased or to be purchased, to the employees of the corporation or to the employees of subsidiary corporations or to a trustee on their behalf, and for the payment of such shares in installments or at one time, and for the establishment of a special fund or funds in which such employees during the period of their employment or other period of time may be privileged to share on such terms and conditions as may be imposed in respect thereof: Provided, That shares otherwise subject to preemptive rights under the provisions of section 31 of this act be allotted and sold under such plan free from such preemptive rights only with the written consent or vote of the holders of a majority of the shares entitled to exercise preemptive rights with respect thereto: Provided further, That any such allotment or sale may be cancelled by mutual agreement between the corporation and any such employee or trustee or in any other legal manner." General Corporation Act, Public Acts, 1931, No. 327.

<sup>23</sup> Sec. 14:9-1 provides: "Any stock corporation formed under any law of this state may, upon such terms and conditions as may be determined in the manner herein after designated, provide and carry out a plan or plans for any or all of the following purposes:

"a. The issue or the purchase and sale of its capital stock to any or all of its employees and those actively engaged in the conduct of its business or to trustees on their behalf, and the payment for such stock in installments or at one time, with or without the right to vote thereon pending payment therefor in full, and for aiding any such employees and other persons in paying for such stock by contributions, compensation for services, or otherwise."

Sec. 14:9-2 provides: "Any of such privileges and powers may be exercised by including appropriate clauses therefor in the original articles of incorporation or in the by-laws at the time of organizing the corporation or where the corporation has been formed without such charter or by-law provisions, the board of directors shall first

formulate such plan and pass a resolution declaring that in its opinion the adoption thereof is advisable, and calling a meeting of the stockholders to take action thereon. The stockholders' meeting shall be held upon such notice as the by-laws provide, and in the absence of such provision upon ten days' notice given personally or by mail. If two-thirds in interest of each class of stockholders present at the meeting and voting shall vote in favor of any such plan or any modification thereof, it shall thereupon become operative."

Sec. 14:9:3 provides: "In case any corporation shall adopt a plan providing for the issue of new stock under paragraphs 'a' . . . any stockholder holding stock issued by such corporation before April fifteenth, one thousand nine hundred and twenty, not voting in favor of the plan, may, within thirty days after the adoption thereof, file with the secretary of the company a dissent in writing therefrom.

"The person so dissenting shall, within ten days after the filing of such dissent, and upon five days' notice to the corporation, apply by petition to the circuit court of the country in which the corporation has its principal office for the appointment of three disinterested appraisers to appraise the fair value of the stock held by such stockholders and issued prior to April fifteenth, one thousand nine hundred and twenty, without regard to any depreciation or appreciation thereof in consequence of the adoption of the plan, whose award, or that of a majority of them, when confirmed by such court, shall be final and conclusive on all parties.

"The corporation shall pay to such stockholder the value of such stock as aforesaid. On receiving such payment, or on a tender thereof, or in case of any legal disability or absence from the state, on the payment of the award into such court, the stock shall be transferred to the corporation, to be disposed of by directors or to be retained for the benefit of the remaining stockholders.

"In case the award is not paid within thirty days from its filing and confirmation by the court and notice thereof given to the corporation, in the manner aforesaid, the amount of the award shall be a judgment against the corporation, and may be collected as other judgments in such court are collected. The court may fill any vacancy in the board of appraisers occurring by refusal or neglect to serve or otherwise.

"The charges and expenses of the appraisers and appraisal as approved by the court shall be paid by the corporation.

"The corporation may, at any time before the proceedings hereinbefore mentioned are instituted or completed, elect to permit the dissenting stockholder to subscribe for his proportionate share of such new stock issued under paragraph 'a' . . . in which event such proceedings shall not be instituted, or, if instituted, shall be terminated upon the payment of the appraisal expenses as aforesaid by the corporation."

Sec. 14:9:4 provides: "Any plan so adopted may be recalled or abolished in the same manner as is herein provided for its adoption, subject, however, to the restoration from any trust fund created by such corporation for carrying out or effectuating any such plan, or by the corporation if no such trust fund has been created, of any moneys contributed by employees or those actively engaged in the conduct of the corporate business, and for which no stock or other equivalent has been issued.\*

"Any plan heretofore adopted or which may hereafter be adopted by any corporation of this State may be amended or revised by the board of directors of the corporation by resolution of said board; provided, however that no such amendment shall be effective which shall attempt to (1) deprive any employee of any shares of the capital stock of the corporation which he may have acquired through or as a result of said pension plan; (2) deprive any employee of his right to participate in the profits of the corporate enterprise or any branch or division thereof; or (3) divert any part of the fund whether corpus or income which may have been set up \*

by the corporation to provide for the payment to or for the benefit of the employees of the corporation, or of any corporation a subsidiary thereof or affiliated therewith, of pensions during old age, disability or unemployment or for the relief or general welfare of any or all such employees.

"Any amendment to or revision of the plan so made by the directors of the corporation may be altered, changed or repealed by the stockholders." General Corporation Law, Revised Statutes of New Jersey, 1937.

<sup>24</sup> Sec. 54-313 provides: "Nothing but money shall be considered as payment of any part of the capital stock of any corporation organized under this article, except as hereinafter provided in the case of the purchase of property and the sale of shares of stock to employees, . . . ; Provided, however, that corporations organized under the provisions of this article shall be authorized to sell on credit, to one or more of its employees, shares of its capital stock not in excess of one-third of the fully paid-in shares of the class of its capital stock of which such shares so sold on credit form a part; Providing, further, that the corporation shall retain possession of its shares of stock so sold on credit, until the same shall have been fully paid for." General Corporation Law, Statutes Annotated, 1941.

<sup>25</sup> Sec. 14 provides: "A corporation other than a moneyed corporation, with the consent of the stockholders entitled to vote thereon, upon such terms and restrictions as they shall impose, and in case of stock having par value for the consideration required by section sixty-nine, may provide and carry out a plan for the issue of any or all of its unissued stock to employees of the corporation or to employees of a subsidiary corporation who may desire to subscribe therefor, or to a trustee on their behalf, and for the payment for such stock in installments or at one time, and for the establishment, if provided for in any such consent, of a special fund or funds derived from surplus profits of the corporation in which employees purchasing stock pursuant to such plan and continuing in the ownership thereof and in the employment of the corporation during a definite period of time may be privileged to share upon such terms and conditions as may be imposed in respect thereof. The consent may be given by all such stockholders in writing or by a majority vote at a stockholders' meeting held on the notice prescribed by section forty-five, stating the object thereof. In case such a plan shall be authorized pursuant to this section, any stockholder having a preemptive right to subscribe to such stock and not voting in favor of such plan, may at any time prior to the vote upon such plan—or if notice of the meeting to vote upon the plan was not mailed to him at least twenty days prior to the taking of such vote, then within twenty days after the mailing of such notice—object to such plan and demand payment for his stock, and thereupon such stockholder or the corporation shall have the right, subject to the conditions and provisions of section twenty-one, to have such stock appraised and paid for as provided in said section. Such objection and demand must be in writing and filed with the corporation. If the consent to such plan is given in writing without a meeting the time of such stockholder to file his objection and demand shall expire on the twentieth day after the mailing to the stockholder of a notice setting forth the plan and stating that the consent in writing of the stockholders entitled to vote thereon has been given to such plan pursuant to this section." Stock Corporation Law, as last amended by ch. 317, L. 1946.

<sup>26</sup> Sec. 8623-36 provides: "A corporation may, upon such terms and restrictions as it may impose, provide and carry out a plan for the allotment and sale of any or all of its unissued shares, or of shares purchased or to be purchased, to the employees of the corporation or to the employees of subsidiary corporations or to a trustee on their behalf, and for the payment of such shares in installments or at one time, and for the establishment of a special fund or funds in which such employees

Companies Act of 1929, provides for the plan likewise.<sup>29</sup> It should, however, be noted that the English law only provides for the use of corporate funds in accordance with a scheme adopted to purchase fully paid shares. No authorized but unissued shares are involved, although, perhaps, treasury shares may be used in a limited quantity. It is not unreasonable to expect that many more states will enact similar legislation in the future in the implementation, despite attacks to the contrary, of the growing sense of the public and social obligation of corporate enterprise.

A point need be noted here in considering the problem of employee stock ownership. In case the management adopts the plan, it may provide, as a condition for employment, that the prospective employee take stocks in the corporation. This would be true whe-

---

during the period of their employment or other period of time may be privileged to share on such terms and conditions as may be imposed in respect thereof; provided, that shares otherwise subject to preemptive rights under the provisions of the preceding section may be allotted and sold under such plan free from such preemptive rights only with the written consent or vote of the holders of a majority of the shares entitled to exercise preemptive rights with respect thereto." General Corporation Act, 1927.

<sup>27</sup> Sec. 47 provides: "Unless otherwise provided in the articles of incorporation, a domestic corporation may, upon such terms and conditions as contained in such articles, or the by-laws, provide for and carry out a plan for the subscription and allotment of its unallotted shares, or sale of any treasury shares held by it, to the employees of the corporation or to the employees of subsidiary corporations or to a trustee on their behalf, and for the payment of such subscription in installments or at one time, and for such consideration as may be fixed, and may provide for aiding any such employees in paying for such shares by compensation for services, by loans, or otherwise. Any such plan may include, among other features, the fixing of eligibility for participation therein, the class and price of shares to be allotted or sold under the plan, the number of shares which may be subscribed for, the method of payment therefor, the reservation of title until full payment, the effect of the termination of employment, an option or obligation on the part of the corporation to repurchase the shares upon termination of employment, restrictions upon the transfer of the shares, and the time limits and termination of the plan." Business Corporation Act, 1947.

<sup>28</sup> Sec. 612 provides: "Unless otherwise provided in its articles, every business corporation may provide and carry out a plan for the issue and sale of its authorized but unissued shares to its employees, or to the employees of any subsidiary corporation, or to a trustee on their behalf, without first offering such shares to its shareholders, upon such terms and conditions, and in such manner as shall be provided in the by-laws, except that shares subject to preemptive rights may be so issued and sold under plan only with the written consent or affirmative vote of the holders of two-thirds of the shares entitled to exercise preemptive rights with respect thereto." Business Corporation Law, Act No. 106, L. 1933.

<sup>29</sup> Provided that nothing in this section shall be taken to prohibit—(b) the provision by a company, in accordance with any scheme for the time being in force, of money for the purchase by trustees of fully-paid shares in the company to be held by or for the benefit of employees of the company, including any director holding a salaried employment or office in the company." Sec. 45, 19 & 20 Geo. 5 c. 23.

ther the jurisdiction has or does not have a regulatory statute as in the foregoing State. And it was at least intimated in Massachusetts that a law nullifying such a contract provision is void.<sup>30</sup> The solution of the matter would, therefore, rest largely on the relative bargaining strength of employee and employer.

An examination of the statutes of the foregoing jurisdictions shows that the initiation of the plan is a discretionary corporate action. The law does not compel adoption of the plan. English law is the same. Some of the statutes, as those of California and Oklahoma, expressly provide that the terms and conditions of the plan be embodied in the articles of incorporation or the by-laws. The Colorado and New Jersey laws contain the same requirement, but go further by enabling corporations that have no appropriate provisions in the articles of incorporation or by-laws to proceed by requiring the board of directors to formulate a plan and submit the same for the approval of the stockholders. The New York law expressly requires stockholders' action, while the rest of the statutes only impliedly require it. It was, however, suggested that where the law does not expressly require it, the board of directors, as a matter of prudence, should seek approval of the stockholders.<sup>31</sup> The reason for this abundant caution is that the sale of stocks to employees is a source of abuse by directors and officers, especially if the statute allows participation by the officers and directors. The American Tobacco Company case is a classic example.<sup>32</sup> That law which, therefore, requires affirmative stockholders' action to a complete plan which leaves no discretion in the officers or directors best protects the interests of the shareholders.

The matter of preemptive rights involves a minor question of policy which has been solved in varying ways by the foregoing statutes. It is not our purpose to discuss the perplexing questions in what situations and as to what shares preemptive rights may be exercised, but where shares subject to preemption are to be sold to employees, the interests of existing shareholders entitled to preemptive rights are clearly involved. The English Companies Act of 1929, as also the law of New Mexico, avoids the difficulty by prescribing the use of corporate assets for the purchase of only fully-

---

<sup>30</sup>"The second question in substance is whether, under the Constitution, legislation may be enacted providing that any contract of employment shall be void where by is included as a consideration for the acceptance of such contract by the employees the purchase by the employee of capital stock of any nature in the business of the employer. This question is answered in the negative." Re Opinion of the Justices, 166 N. E. 401, 63 A. L. R. 838, 840.

<sup>31</sup>Fordham, *op. cit.*, *supra*, at p. 163.

<sup>32</sup>Rogers v. Guaranty Trust Company, 288 U. S. 123, 77 L. Ed. 382. See "Profit Sharing for Executives and Employees—The American Tobacco Company, A Case in Point," 42 *Yale Law Journal*, 419, 422-423; 31 *Michigan Law Review*, 682; 46 *Harvard Law Review*, 828, 829-830; Washington, "The Corporation Executive's Living Wage," 54 *Harvard Law Review*, 733.

paid shares as to which no preemptive rights attach.<sup>33</sup> The Oklahoma law solves the difficulty in the same manner, by limiting sale to employees of only "unallotted" and "treasury" shares, which are generally not subject to preemptive rights.<sup>34</sup> Some of the statutes provide that when shares subject to preemption are involved, a required number of shareholders' votes or written assent is necessary. Thus the California and Pennsylvania laws provide for the vote or written assent of two-thirds of the shares entitled to preemptive rights. Idaho, Louisiana, Michigan, and Ohio require the vote or written assent of only a majority. The Illinois law pays no heed to preemptive rights but the plan, at all events, must be approved by the holders of two-thirds of the shares entitled to vote, although some of these shares may not be entitled to preemptive rights. The Colorado and New York laws treat the matter in different ways. It would seem that a minimum protection of preemptive rights should be all that the law should extend. This would make the adoption of the plan comparatively easier and will not thus compel the corporation to invest in purchasing shares of its own stock, to which no preemptive rights attach. Purchasing shares of its own stock generally requires that the corporation have a surplus out of which purchase may be made, and even granting the presence of a surplus is not required, investment by the corporation necessarily withdraws from the corporate assets a margin of safety of creditors. The fact that the shares acquired by the corporation will be resold to the employees does not immediately restore the balance, for generally the shares are sold on the installment basis running for long periods of time. This recommendation also comports with the modern trend to abolish or curtail preemptive rights.

Another question of policy is raised by the case of dissenting shareholders. Only the New Jersey law gives the right of appraisal to dissenting shareholders, whether entitled or not to preemptive rights. But it imposes the qualification that the shares owned by the holders must have been issued by the corporation before April 15, 1920. New York gives the rights only to shareholders entitled to preemptive rights and provides that the shareholder may object to the plan and demand payment even before the vote is taken. The Colorado law adopts a novel solution. It says: "Any stockholder of any such corporation whose stockholders have such preemptive right, attending said meeting, either in person or by proxy and voting against such plan or plans, may within thirty days from the date of said stockholders' meeting serve a demand in writing upon the secretary of said corporation for the right to purchase his pro rata

---

<sup>33</sup> The use of corporate assets in this manner is clearly an exception to the strict English rule that a corporation may not purchase its own shares. *Trevor v. Whitworth*, 12 App. Cas. 409. See *Palmer's Company Law*, 18th ed., pp. 57-58.

<sup>34</sup> "The articles of incorporation of any corporation formed or existing under this Act may provide that the shareholders shall have preemptive rights to subscribe for any additional shares or any obligations convertible into shares to be allotted or issued by the corporation, and may provide any restrictions on such rights as may be desired, but except as provided in the articles of incorporation no shareholder shall have any such preemptive right." Sec. 45, Business Corporation Act, 1947.

share of any new stock to be issued under said plan at the price therein provided for, but if such demand is not made in writing, as aforesaid, within thirty days after the holding of such stockholders' meeting, any preemptive rights of such dissenting stockholder to any stock issued or to be issued, sold or to be sold, under said plan, shall be forever barred."<sup>35</sup> It will be observed that the right given by the law is limited to those entitled to preemptive rights and that it is not a right to appraisal and to demand payment for his shares from the corporation, but only to enforce his pro rata participation in the shares subject to preemption. The rest of the States, California, Idaho, Illinois, Louisiana, Michigan, New Mexico, Ohio, Oklahoma, and Pennsylvania, give no remedy to dissenting shareholders whether entitled or not to preemptive rights. The former laws of California,<sup>36</sup> Illinois,<sup>37</sup> Ohio,<sup>38</sup> and Pennsylvania<sup>39</sup> provided for remedies of dissenting shareholders. The trend is thus clear. It is believed in these States which afford no protection that the vote or written assent required by the law gives sufficient protection. And we do not see why this should not be sufficient.

Whether employees or also officers and directors should be included in the plan has become an important question since the American Tobacco Company case. All of the States above mentioned, with the exceptions of Colorado and New Jersey, expressly mention only employees. Colorado and New Jersey expressly include, however, officers actively engaged in the conduct of business of the corporation. Under the New York law, it was held that officers and directors were excluded.<sup>40</sup> Recommendations to this effect have, indeed, been made.<sup>41</sup> Opinion, however, is advanced that under the Ohio law officers and directors would be included if they render service to the corporation and receive salaries therefor.<sup>42</sup> The English Companies Act of 1929 expressly follows this last opinion. While the abuses arising out of the American Tobacco Company case were largely due to the fact that not all details of the plan were disclosed to and voted by the shareholders, it must be admitted that a plan including directors and officers to its benefits would offer powerful temptations to them. It is best that the law makes sufficiently clear that officers and directors are excluded from the plan. The extension of the plan to employees not only of the corporation concerned but also of its subsidiaries should likewise be made clear.

<sup>35</sup> Sec. 42, *op. cit.*, *supra*.

<sup>36</sup> California Laws of 1921, ch. 34, sec. 3. See also Ballantine, Sterling and Buhler, *California Corporation Laws*, 1949, p. 144.

<sup>37</sup> See 1 The Chicago Bar Association, *Illinois Business Corporation Act Annotated*, 1947, p. 132.

<sup>38</sup> See Davies, *Ohio Corporation Law*, 1942, pp. 620-621.

<sup>39</sup> See comment in Prentice-Hall, *Corporation Service*, under sec. 612, statute of Pennsylvania.

<sup>40</sup> See 3 White, *New York Corporations*, 12th ed., 1949, p. 343, citing *In re Taliafero*, *N. Y. Law Journal*, March 13, 1939, p. 1159.

<sup>41</sup> Comment in 21 *California Law Review*, 358, 366; Ballantine, Sterling and Buhler, *op. cit.*, *supra*, p. 146.

<sup>42</sup> 1 Davies, *op. cit.*, *supra*, p. 621.

A careful examination of the foregoing statutes reveal that those of Michigan, Idaho, California, and Ohio allow the use of unissued shares, as well as those purchased or to be purchased. Needless to say, they would also allow the use of new issues and treasury shares. The statutes of Louisiana, Illinois, and New Jersey, by failing to specify what shares should be used, impliedly allow the use of all kinds. Oklahoma, by expressly mentioning unallotted and treasury shares, also allows the use of all kinds, excepting, perhaps, additional shares. Only New Mexico, like the English Companies Act of 1929, requires the use of fully-paid shares. New York and Pennsylvania specify unissued shares, while Colorado adds shares to be authorized. There is, however, nothing to prevent New York and Pennsylvania to use shares to be authorized, provided the law be followed in increasing the capital stock. But all three States, New York,<sup>43</sup> Pennsylvania,<sup>44</sup> and Colorado<sup>45</sup> authorize the purchase by the corporation of its own shares, under specific limitations. There seems, therefore, no reason in these States why treasury shares or those purchased or to be purchased may not be utilized for employee stock plans, provided, in all cases, that the requirements of the law be followed and creditors are not injured. The corporate management should be given in this regard a wide latitude of freedom.

The other terms and conditions of the plan as to eligibility of employees, the use of common or preferred shares or both, retention by the employees of the shares during a certain period of time, option or right to repurchase or resell, price of shares, terms of payment, voting rights, whether the shares should be held by trustees for the employees, etc., should be left to the corporation to decide. These questions involve business judgment as to which legal control is not necessary. The economic studies conducted in this field by a number of writers should be of great assistance to management and shareholders. A decision on any one of the subjects suggested is of the same category as that whether the stock-purchase plan should, in the first instance, be adopted.

There is no law in the Philippines which treats of the subject discussed. While a law is unnecessary to vest power, it is essential as a regulatory measure. The enactment of such a law would accomplish a second purpose of bringing before the attention of Philippine business a development in America and England which may well be used to promote social ends. Such proposed enactment should observe the recommendations in this article.

---

<sup>43</sup> *In re Fechheimer Fishel Co.*, 212 Fed. 357, certiorari denied, 234 U. S. 760; *Grasselli Chemical Co. v. Aetna Explosives Co., Inc.*, 258 Fed. 66; *Melniker v. Am. Title & Guaranty Co.*, 253 N. Y. App. Div. 570, 3 N. Y. Supp. (2d) 198; *Syracuse Transit Corp. v. Girard Trust Co.*, 266 N. Y. App. Div. 815, 41 N. Y. Supp. (2d) 583.

<sup>44</sup> Sec. 302, Business Corporation Law, Act No. 106, L. 1933.

<sup>45</sup> Sec. 24, Colorado Statutes Annotated, 1935, ch. 41.