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## STOCKHOLDER ATTACKS ON CORPORATE PENSION SYSTEMS

F. HODGE O'NEAL \*

This article considers the legal issues raised when a corporate pension system is attacked by minority stockholders. These issues perhaps best can be delineated by focusing attention on a representative fact-situation.

The board of directors of a corporation formulate a pension plan for corporate officers and employees. Retirement benefits under the plan are to be based on employees' "past service" (*i.e.*, service rendered the company prior to the effective date of the plan) as well as on their "future service" (*i.e.*, service rendered after the plan is in operation). The plan includes provisions for funding the pensions with either a trust company or an insurance company. Perhaps a number of the officer-beneficiaries of the plan are on the board of directors or are principal stockholders. The plan is submitted to the stockholders and it is approved by a majority vote. Stockholders who oppose the plan go to court to enjoin the corporation and its officers from putting it into operation. The legality of the pension system may be challenged on one or more of the following grounds: (1) a corporation does not have authority to establish a pension system; the payment of pensions is *ultra vires* because pensions constitute gifts of corporate assets; (2) the granting of pensions based on past service is especially objectionable since past service benefits are nothing more than additional compensation for "past performances"; (3) the particular pension system adopted is unsound and will result in a waste or "spoliation" of corporate assets; (4) a disproportionate share of expenditures under the pension system is to be used to purchase benefits for corporate directors or executives; (5) interested directors or officers breached fiduciary duties to the corporation to obtain the adoption of the project; (6) the plan was not acted on by the proper corporate representatives; (7) fatal defects or omissions invalidated the acts purporting to adopt the plan.

### I. THE RAPID GROWTH OF FORMAL PENSION SYSTEMS AND AN OUTMODED JUDICIAL APPROACH

Before examining the various problems raised by stockholder attacks on pension plans, mention should be made of the rapid growth of formal

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pension systems and the lag between the modern science of pension planning and judicial thinking on pension questions. Formal pension systems setting forth definite procedures to govern the granting of retirement benefits to employees are products of twentieth-century business. Prior to 1900 even those employers who looked after their superannuated employees did not follow a predetermined program or system in granting pensions.<sup>1</sup> Each aged employee was dealt with individually. Pension benefits ordinarily were based on the needs of the beneficiary and on the employer's estimate of the value of the services he had rendered the company.<sup>2</sup> No attempt was made to set up a scientific method of awarding pensions or to calculate in advance the probable cost of pensions and to "fund" such costs. Since 1900, on the other hand, thousands of American businesses (mostly corporations), impelled by dynamic social and economic forces, have adopted formal pension systems.<sup>3</sup> The increase in the number of pension plans was particularly marked during World War II when many long-deferred pension projects, scheduled by business executives for "some tomorrow," suddenly became feasible and economical. The number of pension plans still is increasing constantly, and fundamental long-term factors indicate that pension systems will remain a vital part of American business life.<sup>4</sup> Yet many courts are still thinking in terms of discretionary, man-by-man pensions. If that fact is kept in mind, decisions which otherwise could not be accounted for become intelligible.

## II. CORPORATE AUTHORITY TO ESTABLISH PENSION SYSTEMS—"FUTURE SERVICE" BENEFITS

Pension benefits may be based on service rendered after the inauguration of a pension plan, on service rendered prior to the establishment of the plan,

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1. O'NEILL, *MODERN PENSION PLANS: PRINCIPLES AND PRACTICES* 31-2 (1947); WYATT, *PRIVATE GROUP RETIREMENT PLANS* 20 (1936). Some businesses still follow informal, "unfunded," man-by-man pensioning procedures.

2. Naturally, corporate officers, stockholder-employees, and supervisory employees were more likely than other employees to receive favorable treatment on retirement.

3. At the end of 1946 at least 7,500 formal, funded pension plans were in operation; about 4,000,000 employees were covered by such plans. Lipton, *Insured Plans in TRENDS IN RETIREMENT PLANNING* (Am. Management Ass'n, Ins. Ser. No. 73) 17. See also LATIMER AND TUFEL, *TRENDS IN INDUSTRIAL PENSIONS* 3 (1940). During the year that ended June 30, 1948, the Bureau of Internal Revenue received 1,154 requests for rulings on new plans designed to qualify under INT. REV. CODE § 165(a).

The adoption of formal pension plans was stimulated by the entry of insurance companies into the pension field in the 1930's; by the success of the social security law; by the incentive to constructive spending concomitant to huge wartime corporate earnings, high corporate and personal income taxes, and the excess profits tax; by wartime wage and salary stabilization rules which induced employers to use pension plans as extra-compensation devices to hold experienced employees or to attract new personnel; and, last but probably most important, by tax advantages obtainable by both employers and employees through the adoption of pension systems approved by the Treasury Department. See Jensen, *Private Pension Plans*, 60 *FORUM* [No. 1] 13 (July 1948); WASHINGTON, *CORPORATE EXECUTIVES' COMPENSATION* 132 (1942).

4. Long-term factors listed in O'NEILL, *MODERN PENSION PLANS: PRINCIPLES AND PRACTICES* 28 (1947), include (1) a shift from an agricultural to an industrial economy, (2) the development of large scale enterprise, (3) the rise in the average age of the population.

or on both past and future service. The most commonly employed pension formulas provide pension benefits equal to: (1) a percentage of average annual earnings for each year of participation in the plan, or (2) a percentage of average earnings for each year of service rendered prior to retirement, or (3) a percentage of an average of *final* earnings for each year of service, or (4) a percentage of average annual earnings for each year of service after the effective date of the pension system *plus* a (frequently smaller) percentage of average annual earnings for each year of service prior to the effective date of the pension system.<sup>5</sup> Pension systems adopted in the last few years almost invariably are composites of two separate formulas—one for determining future service benefits and the other for computing past service benefits.<sup>6</sup>

The initial issue in a suit by stockholders to challenge a pension system is whether the establishment of the system is beyond the scope of authorized corporate activity. The stockholders bringing the suit may resort to the technical *ultra vires* argument and assert that pensions are "gifts," that a corporation, since it must confine its expenditures to corporate purposes set forth in the articles of incorporation, is legally incapable of becoming a donor.<sup>7</sup> Some support for this contention can be drawn from pension rules and regulations stipulating that pensions shall be considered gifts. Stipulations to that effect are found in most pension plans.<sup>8</sup> The *ultra vires* argument, however, completely loses its force when the cases are examined and an inquiry is made into the purposes served by pension systems and into the practical personnel problems faced by modern businesses.

Corporate authority to grant future service benefits will be discussed

5. O'NEILL, MODERN PENSION PLANS: PRINCIPLES AND PRACTICES 201 (1947).

6. See for example the following booklets: PENSION PLAN OF BROCKTON-EDISON COMPANY 3-4 (July 1, 1946); RETIREMENT INCOME PLAN, THE MARKET STREET NATIONAL BANK OF PHILADELPHIA 4 (July 16, 1947).

The following provisions from a group annuity contract issued by the Equitable Life Assurance Society of the United States illustrate possible refinements in a modern formula for computing past service benefits:

"The past service annuity with respect to an employee who becomes included in the Plan as of May 1, 1948 shall be the amount of monthly annuity equal to 1/12 of the product of

- (a) .6 of 1% of the first \$1800 of the employee's annual earnings plus .8 of 1% of the portion of such earnings in excess of \$1800 but not in excess of \$3000 plus 1.2% of the portion of such earnings in excess of \$3000 but not in excess of \$30,000 and
- (b) the number of years (with appropriate adjustment for completed months) of the employee's service with the Employer from the date of his completion of five years of such service or his thirtieth birthday, whichever is later, to May 1, 1948.

For the purpose of computing the past service annuity, the Employer will determine an employee's annual earning on the basis of his earnings during the first three months of 1948." (Page 8.)

7. A somewhat similar attack often is made on public pension plans. See the collection of cases in Note, 37 A. L. R. 1162-66 (1925).

8. The great majority of pension systems contain a variant of the following: "The pensions are the voluntary gifts of the company and create no contracts and confer no rights."

separately from corporate authority to award past service pensions; different legal considerations are involved.

Most authorities now recognize that corporations, in the absence of statutory, charter or by-law prohibition, have authority to create pension systems which grant benefits reasonably related to services to be rendered after the plan is in operation.<sup>9</sup> Additional support for the position that corporations have authority to establish future service pension plans is afforded inferentially by the cases holding that employees obtain contractual rights under pension plans.<sup>10</sup> Furthermore, several states have enacted statutes which expressly authorize corporations to provide pensions for their employees.<sup>11</sup> New Jersey, for instance, has a statute which permits a corporation created under the laws of that state to "form and carry out a plan or plans for . . . furnishing to its employees wholly or in part at the expense of the corporation . . . pensions during old age."<sup>12</sup>

Some of the decisions which sanction future service pensions do so on the theory that they constitute deferred compensation, something to be added to the basic salaries of the employees in calculating their total remuneration.<sup>13</sup> Pensions, since they form a part of the inducement for employees to enter and remain in employment, reasonably may be considered compensation for services. If this conception of the nature of pensions is accurate, corporate authority to establish pension systems is clear.<sup>14</sup> Surely, the whole compensation need not be paid at the time services are rendered. Under this view, the rules and regulations of a pension system announce, not the conditions annexed to gratuities, but the terms of legal offers to pay pensions in return for requested performances.<sup>15</sup>

Corporations often receive, in return for pensions they grant, consideration other than the employees' usual services.<sup>16</sup> For example, employees may

9. *Heinz v. National Bank of Commerce*, 237 Fed. 942 (C. C. A. 8th 1916); *Gilbert v. Norfolk & W. Ry.*, 114 W. Va. 344, 171 S. E. 814 (1933); *In re Prudential Assurance Company's Trust Deed*, [1934] 1 Ch. 338; WASHINGTON, CORPORATE EXECUTIVES' COMPENSATION 133 (1942); Handy, *Private Pension Plans and the Federal Revenue Act*, 16 N. Y. U. L. Q. REV. 408, 411 (1939). Cf. *Southern Hide Co. v. Best*, 174 La. 748, 141 So. 449 (1932). The inauguration of a pension system is permissible whether it is contributory or non-contributory, *i.e.*, the corporation may pay the entire pension cost or the employee may contribute a part of that cost.

10. *Psutka v. Michigan Alkali Co.*, 274 Mich. 318, 264 N. W. 385 (1936); *Wilson v. Rudolph Wurlitzer Co.*, 48 Ohio App. 450, 194 N. E. 441 (1934); *McLemore v. Western Union Telegraph Co.*, 88 Ore. 228, 171 Pac. 390 (1918); *Texas & N. O. R. R. v. Jones*, 103 S. W. 2d 1043 (Tex. Civ. App. 1937); *Schofield v. Zion's Co-Op. Mercantile Institution*, 85 Utah 281, 39 P. 2d 342 (1934).

11. N. J. REV. STAT., tit. 14, c. 9, art. 1 (1937); PA. BUS. CORP. LAW § 316 (1933), as quoted in *Osborne v. United Gas Improvement Co.*, 354 Pa. 57, 46 A. 2d 208, 211 (1946). Cf. COLO. STAT. ANN. c. 41, § 40 (1935).

12. N. J. REV. STAT. tit. 14, c. 9, art. 1.

13. *Nemser v. Aviation Corp.*, 47 F. Supp. 515 (D. Del. 1942); *Wilson v. Rudolph Wurlitzer Co.*, 48 Ohio App. 450, 194 N. E. 441, 443 (1934).

14. See WASHINGTON, CORPORATE EXECUTIVES' COMPENSATION 133 (1942).

15. For a discussion of pension plans as resulting in enforceable contracts, see 34 MICH. L. REV. 420 (1936).

16. A corporation has authority to contract to pay a pension to stockholder's wife

promise that after they are pensioned they will render assistance to the corporation in emergencies or in other unusual situations or they may promise not to accept employment with competing companies.<sup>17</sup>

Stockholders attacking a pension system can point to many cases in which pension payments were treated as gratuities.<sup>18</sup> That conception of pensions early found its way into judicial thinking. When the first pension systems were installed, the science of gauging expenditures ultimately to be required was undeveloped. Further, at that time there was no place in accounting practice for the current funding and ultimate discharge of pension liabilities. Employers naturally hesitated to assume liabilities which they could not measure. They also were reluctant to commit themselves to pay pensions permanently because business vicissitudes well might leave them with insufficient funds to meet heavy fixed liabilities. These facts in part explain stipulations inserted into most plans to the effect that pensions are to be considered as gifts and that contract rights are not to result. The courts, faced with these express provisions and aware of the perplexing problems confronting employers, evolved the theory that the establishment of a pension system does not invite contractual relations but rather manifests an intention of the employer to make "gifts" subject to the conditions set forth in the plan. This postulate avoided the imposition of contractual responsibilities on the employer and obviated the necessity of devising accounting methods to record pension liabilities. A strengthening of the "gift" theory resulted from the fact that initial payments under most of the early plans went to employees retiring on or near the effective date of the plan. The courts, thinking in terms of traditional contract principles, were impressed by the "past consideration" aspect of the services on which the pensions were based and the legal insufficiency of "past consideration" to support a promise. The notion that pensions are gratuities became firmly embedded in legal thought.

An examination of the cases that treated pensions as gifts, however, shows that they were not suits by stockholders to contest corporate authority to award pensions. They were suits brought by employees, on the theory

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in consideration of a reduction of rental to the corporation on property owned by the stockholder. *Markson v. Markson's Furniture Stores, Inc.*, 267 N. Y. 137, 195 N. E. 824 (1935).

17. See *Langer v. Superior Steel Corporation*, 105 Pa. Super. 579, 161 Atl. 571 (1932). "Behavior" clauses in the pension plan often prevent the pensioned employee from working for a competing company.

18. *McNevin v. Solvay Process Co.*, 32 App. Div. 610, 53 N. Y. Supp. 98 (4th Dep't 1898), *aff'd mem.*, 167 N. Y. 530, 60 N. E. 1115 (1901); *Dolge v. Dolge*, 70 App. Div. 517, 75 N. Y. Supp. 386 (4th Dep't 1902). *Cf. Cowles v. Morris & Co.*, 330 Ill. 11, 161 N. E. 150 (1928). A public pension often has been held to be a gratuitous allowance and not creative of contractual obligation. *United States v. Teller*, 107 U. S. 64, 2 Sup. Ct. 39, 27 L. Ed. 352 (1883); *Pennie v. Reis*, 132 U. S. 464, 10 Sup. Ct. 149, 33 L. Ed. 426 (1889); *People ex rel. Donovan v. Retirement Board Policemen's Annuity and Benefit Fund*, 326 Ill. 579, 158 N. E. 220 (1927). *But see Klensch v. Board of Pension Fund Comm'rs*, 79 Cal. App. 171, 249 Pac. 46 (1926), 40 HARV. L. REV. 504 (1927).

that they had acquired contract rights, to compel reluctant employers to pay promised pensions. Furthermore, now that the science of pension planning has progressed to a point that future pension liability can be measured with reasonable accuracy and provision can be made for funding the liability, a notion that pensions awarded systematically are gifts seems to be outmoded. Of course, many variable factors are involved in pension plans, and whether a pension is a gift depends on the terms under which it was granted and the considerations inducing its award. Yet practically all pensions, particularly those pursuant to formal pension systems, are awarded, not from motives of charity, but for "substantial business reasons"; pensions are not donated in any real sense. And perhaps equally important, employees today unquestionably feel that a pension system affords them security, confers rights which can be enforced—in short, operates to discharge an obligation impliedly assumed by the employer as a normal incident to the employer-employee relation. Probably as a result of the evolution in pension practices and the change in the attitude of employees and the public toward pensions, courts which formerly treated pensions as gifts and still feel bound to adhere to their holdings nevertheless are manifesting dissatisfaction with the position they have taken and are inviting change by the legislature or by higher appellate courts.<sup>19</sup>

But a determination that pensions are deferred compensation is not essential to sustain corporate authority to inaugurate pension systems. Expenditures for pensions, even if viewed as gratuities, should receive legal sanction because pensions redound to the "profit-making" good of the corporation.<sup>20</sup> It is elementary that a corporation has authority to perform those acts which are appropriate to the accomplishment of its objectives. Consistent with the general rule that the business of a corporation is carried on primarily for the benefit of its stockholders and that therefore its activities must be directed toward profit-making, the courts generally hold that a corporation may expend its funds for purposes which appear to be charitable and humanitarian if the corporation itself ultimately benefits and those benefits can be translated into profit.<sup>21</sup> The trend more and more seems to

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19. "That this retirement Plan . . . was adopted by the defendant in recognition of some obligation to its employees is hardly open to doubt in the light of contemporary progress in labor relations, but where, as here, the retirement Plan is not included in a contract between the employer and employee, the courts are without choice but to hold that the benefits . . . are entirely voluntary and gratuitous on the part of the employer. [Cases]. This conclusion of the law does not necessarily coincide with actuality and in some cases may be so contrary to fact as to shock the conscience of the court that utters it. The law should keep pace with social progress but in the very nature of the judicial process it must be a laggard as courts of original jurisdiction await the lighting of each new torch in our appellate tribunals." *MacCabe v. Consolidated Edison Co., Inc.*, 30 N. Y. S. 2d 445, 447 (N. Y. City Ct., 1941).

20. See *Gilbert v. Norfolk & W. Ry.*, 114 W. Va. 344, 171 S. E. 814, 815 (1933).

21. *Greene County Nat. Farm Loan Ass'n v. Federal Land Bank*, 57 F. Supp. 783 (W. D. Ky. 1944); *Wachovia Bank & Trust Co. v. Steele's Mills*, 225 N. C. 302, 34 S. E. 2d (1945); cases collected in Note, 3 A. L. R. 443 (1919).

be to uphold expenditures even though corporate benefits therefrom are indirect or even conjectural.<sup>22</sup>

The sharp increase in the number of corporate pension plans is convincing testimony that pension plans tend to further corporate interests.<sup>23</sup> Corporate pension systems are not adopted from motives of charity or for humanitarian reasons alone but primarily because of a conviction that they serve corporate purposes.

The advantages derived from pensions are numerous.<sup>24</sup> Old age is not compatible with the speed, efficiency and safety required by modern business methods. Pension systems, in addition to retiring the superannuated, increase the efficiency and enhance the morale of the remaining employees by eliminating worry about old age. The vacancies created through retirements and the resulting promotions of men in the lower ranks also serve to improve morale and to stimulate the employees to greater efforts. That pensions improve personnel efficiency and morale alone should be sufficient to sustain corporate authority to grant them.

But many other advantages accrue from the adoption of a sound pension policy. Economies accompany the elimination of the superannuated employees. The older men, because of their seniority, frequently receive greater compensation than their services warrant. Payrolls often can be reduced by filling positions vacated by retirements with younger men at lower salaries. Further, a sound pension policy adds to the prestige of the employer in the community, tends to attract desirable employees, and diminishes labor turn-over. Some executives even feel that pension plans, at least those under which employees lose their pension rights if they leave employment, allay labor unrest. Availability of capable labor and continuity of service have acknowledged worth in business. Finally, pension plans promote public good will. The public is inclined to look with favor on companies with enlightened labor policies and to respond with increased patronage.

Pension costs in some form are inevitable. If superannuated employees are not pensioned, they must be discharged or transferred to easier jobs. If they are discharged, employee morale suffers and the good will of the community is lost. Supervisory officials are extremely reluctant to discharge aged employees who do not have some means of support. Further, the labor

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22. "The field of corporate action in respect to the exercise of incidental powers is thus, I think, an expanding one. As industrial conditions change, business methods must change with them, and acts become permissible which at an earlier period would not have been considered to be within corporate power." Beekman, J., in *Steinway v. Steinway & Sons*, 17 Misc. 43, 40 N. Y. Supp. 718, 720 (Sup. Ct. 1896).

23. "It is now generally agreed by business executives and industrial relations men that an adequate pension plan is a good business investment." Folsom, *Coordination of Pension Plans for Social Security Provisions*, in THE EDISON ELECTRIC INSTITUTE BULLETIN 527 (Nov. 1939).

24. The benefits which employers derive from pension systems are elaborately discussed in Chief Justice Hughes' dissent in *Railroad Retirement Board v. Alton R. R.*, 295 U. S. 330, 376-81, 55 Sup. Ct. 758, 79 L. Ed. 1468 (1935).



market of the corporation is impaired. Intelligent employers simply do not release aged employees without providing pensions.<sup>25</sup> Every important company long has had some way of taking care of aged employees who have spent a lifetime working for it.

At best transferring workers to easier tasks is only a temporary expedient. There are few easy jobs. To keep workers on after their usefulness is past is merely to bury the pension cost among other items.

If the granting of pensions is a permissible corporate practice, the establishment of formal pension systems is a reasonable and practical means of exercising that authority. As a matter of fact, a formal pension plan clearly is preferable to the discretionary, man-by-man pensioning procedure. A discretionary procedure lays the corporation open to charges of favoritism and discrimination. Employees often are not satisfied because a discretionary procedure provides negligible security and uncertain benefits. Further, since pension benefits are not funded in advance, the employer possibly will find himself faced at some future time with pressing financial problems. That some corporations still follow informal, discretionary pension policies is probably ascribable to a lack of information on the part of both management and employees.<sup>26</sup> The inauguration of a formal, actuarially sound, adequately financed pension system is not only a permissible but a desirable corporate activity.

A recent decision of the United States Circuit Court of Appeals for the Seventh Circuit,<sup>27</sup> holding that pension plans are subject to collective bargaining, adds force to the argument that under present-day business conditions corporate authority to establish pension systems must be recognized. Organized labor in the future is expected to concentrate on pension plans in its contract negotiations<sup>28</sup> and to attempt to force the adoption of formal pension systems by concerns which do not now have them. Unless the authority of corporations to establish pension plans is acknowledged, many corporations may find themselves faced with insuperable labor problems.

Under prevailing social and economic conditions, some provision for systematic retirement of the superannuated is essential. Formal pension systems are sound economics, and the law should be grounded on the under-

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25. Some business leaders believe that it is to the interest of corporate businesses to establish private pension systems in order to forestall legislation establishing compulsory and universal old age pension systems.

The argument sometimes is made that economic security is essential to the survival of the capitalistic system, that the prospect of insecurity in old age well might prove a potent incentive for workers to overthrow the capitalistic system, that corporations should have the inherent power to adopt pension plans or to take other measures necessary to preserve the economic system under which they thrive.

26. O'NEILL, *MODERN PENSION PLANS: PRINCIPLES AND PRACTICES* 32 (1947).

27. *Inland Steel Co. v. National Labor Relations Board*, 170 F. 2d 247 (C. C. A. 7th 1948).

28. Wickenden, *Labor's Growing Interest in Formal Retirement Plans*, Chicago Journal of Commerce, Sept. 14, 1948, p. 3, col. 2.

lying economic structure. Minority stockholders today have little if any chance of successfully challenging corporate authority to establish a reasonable pension system, at least where only future service benefits are awarded under the system.

### III. CORPORATE AUTHORITY TO ESTABLISH PENSION SYSTEMS—"PAST SERVICE" BENEFITS

The authority of corporations to establish pension systems granting benefits based in whole or in part on past service<sup>29</sup> is more controversial. The greatest doubt exists where the plan provides pensions for persons (a) who already have retired from active service at the time the plan goes into operation, or (b) who are scheduled to retire such a short time after the plan goes into effect that the services they are to render before retiring obviously are not on a par with the proposed pension payments.<sup>30</sup> The objection of minority stockholders to past service pensions is that full and adequate payment has been made for the services on which the pensions are based and that therefore the payments are unlawful because no consideration is to be received for them.

The courts in this country, when first faced with the question, ruled that pensions based on past service were invalid.<sup>31</sup> The two leading cases adopting that point of view were *Beers v. New York Life Insurance Co.*<sup>32</sup> and *Alexander v. Equitable Life Assurance Society*.<sup>33</sup> In the case first mentioned, Beers had been president and a member of the board of trustees of defendant insurance company for a number of years. In 1891 the Superintendent of Insurance, after an examination of the corporation's affairs, issued a report exposing large losses by the company "arising from gross neglect and incompetency in its management." Soon thereafter, at a meeting of the board of trustees, Beers resigned; and on the day of his resignation, officers of the corporation on its behalf and pursuant to a resolution of the board of trustees contracted to pay him for the remainder of his life an annuity of \$37,500 (half his former salary). Beers in return promised to serve the company in an advisory capacity and to refrain from any activity which

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29. The usual group annuity formula for past service benefits relates them to the years of past service and the compensation received. Past service credit customarily is less in amount than that provided for future service. Since the contributions necessary to purchase past service benefits are far beyond the average employee's ability to pay, the total cost almost invariably is met by the employer alone. O'NEILL, MODERN PENSION PLANS: PRINCIPLES AND PRACTICES 124 (1947). The employer may fund past service pensions by paying immediately the full cost of the pensions to a pension trust or to an insurance company or he may amortize the cost of the past service pensions over a period of years.

30. See WASHINGTON, CORPORATE EXECUTIVES' COMPENSATION 133 (1942).

31. *Beers v. New York Life Ins. Co.*, 66 Hun 75, 20 N. Y. Supp. 788 (Sup. Ct. 1892); *Alexander v. Equitable Life Assur. Soc.*, 233 N. Y. 300, 135 N. E. 509 (1922).

32. 66 Hun 75, 20 N. Y. Supp. 788 (Sup. Ct. 1892).

33. 233 N. Y. 300, 135 N. E. 509 (1922).

would compete with it. When the first pension payment became due, the corporation refused to pay and Beers brought suit. The court examined into the circumstances surrounding the contract and held that it was not obligatory. The court, after finding that the rendition by Beers of future services to the corporation actually was not contemplated and that an idea to compensate Beers for past service permeated the resolution of the board of trustees and the contract recitals,<sup>34</sup> held that a corporation does not have authority to contract to pay a pension grounded upon past service. In further substantiation of its decision, the court held that a board of trustees "have no power to make a perpetual contract."<sup>35</sup> The language used in the opinion clearly indicates that the court was influenced by Beers' negligence and the resulting injury to the corporation and by a feeling that he had exercised undue influence by his attendance at board meetings.<sup>36</sup>

In *Alexander v. Equitable Life Assurance Society*,<sup>37</sup> the New York Court of Appeals enunciated the rule that a contract to pay a pension must be supported by consideration afforded by future services. The corporation in 1888 entered into a contract with Alexander, then vice-president, to pay him a stipulated salary for his services as vice-president. The contract further provided that in return for certain services "rendered and to be rendered by him" outside of his duties as vice-president, the corporation after his death would pay his widow during her life an annuity of \$18,000. Alexander resigned in 1905. After his death in 1915, the wife brought suit to recover annuity installments alleged to be due. The court held that she had not established that Alexander had fully performed his part of the contract; that, in respect to the services rendered prior to the agreement, she would be required to prove at least prima facie that "they were of a character and rendered under such conditions as imposed a legal obligation on the corporation to pay therefor."<sup>38</sup>

The *Beers* and *Alexander* cases often have been seized upon by minority stockholders to attack modern plans. Those cases, however, are not controlling where the issue is corporate authority to establish a pension plan, even if the plan includes past service benefits. In the first place, the suit in each of those cases was brought, not by a stockholder seeking to prevent the award of a pension, but by an individual claiming a pension against a corporation refusing to pay it. A court well might hold that an agreement to pay a

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34. 20 N. Y. Supp. at 792.

35. *Ibid.* For a discussion of the directors' power to enter into long-term contracts, see 85 U. of Pa. L. Rev. 849 (1937).

36. 20 N. Y. Supp. at 790. The New York Court of Appeals in distinguishing the *Beers* case many years later stated that the court in that case decided "that the contracts made by the insurance company worked a fraud upon the policyholders." *Markson v. Markson's Furniture Stores*, 267 N. Y. 137, 195 N. E. 824, 826 (1935).

37. 233 N. Y. 300, 135 N. E. 509 (1922).

38. 135 N. E. at 511.

pension based on past services is not binding on a corporation because of an absence of consideration to support the corporation's undertaking, and still be willing to recognize that a corporation, in view of benefits redounding to it, has authority to pay past service pensions over the objections of minority stockholders. Further, the opinion has been expressed that the decisions in the two cases were influenced by the life insurance scandals which occurred at the turn of the century.<sup>39</sup>

A study of the two cases discloses other facts to have been present in one or both which impair their usefulness in an attack on a pension system. Those facts include: (1) the pension was an individual one, granted by a discretionary procedure and not pursuant to a system covering all employees or a class of employees; (2) the pension was awarded to an officer of the corporation or to the widow of an officer; (3) the amount of the contemplated pension payment was disproportionate to the officer's contributions to the welfare of the corporation; (4) evidence existed that the officer breached a fiduciary duty to the corporation by exerting influence to secure the award; (5) the contract to pay the pension was entered into only a short time prior to the officer's retirement; (6) the purpose of the pension award was not to benefit the corporation; and (7) stockholder approval of the pension contract was not obtained.

Minority stockholders may argue that the rules applicable to bonuses should be extended to past service pensions and that such pensions are nothing more than bonuses payable periodically over an extended but indefinite period of time. Perhaps a glance at the legal principles governing the award of bonuses by corporations is appropriate at this point.

The rule generally has been accepted in the past that bonuses cannot be granted to officers or directors as additional compensation for services already rendered and paid for at a stipulated rate of compensation.<sup>40</sup> The courts, however, seem to be departing from that rule. Many recent decisions indicate that it does not apply where the services were rendered with an understanding, formal or informal, that the fixed salary constituted only a minimum compensation and that bonuses would be paid as an additional allowance.<sup>41</sup> Thus, if a corporation regularly has paid bonuses in the past or if corporations similar in character commonly pay bonuses, a bonus payment

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39. See WASHINGTON, *CORPORATE EXECUTIVES' COMPENSATION* 136 (1942).

40. *Hurt v. Cotton States Fertilizer Co.*, 159 F. 2d 52 (C. C. A. 5th 1947); *Vaught v. Charleston Nat. Bank*, 62 F. 2d 817 (C. C. A. 10th 1933); *National Loan & Investment Co. v. Rockland Co.*, 94 Fed. 335 (C. C. A. 8th 1899); *Richardson v. Blue Grass Mining Co.*, 29 F. Supp. 658 (E. D. Ky. 1939), *aff'd mem.*, 127 F. 2d 291 (C. C. A. 6th 1942), *cert. denied*, 317 U. S. 639 (1942); *Ellis v. Ward*, 137 Ill. 509, 25 N. E. 530 (1890); *Godley v. Crandall & Godley Co.*, 212 N. Y. 121, 105 N. E. 818 (1914); *Baker v. Cohn*, 42 N. Y. S. 2d 159 (Sup. Ct. 1942); BALLANTINE, *CORPORATIONS* § 75 (2d ed. 1946).

41. *McQuillen v. National Cash Register Co.*, 112 F. 2d 877, 883 (C. C. A. 4th 1940); *Church v. Harnit*, 35 F. 2d 499, 501 (C. C. A. 6th 1929); *Calkins v. Wire Hardware Co.*, 267 Mass. 52, 66, 165 N. E. 889, 895 (1929).

is likely to be sustained even in the absence of a stipulation for bonuses in the contract of employment. The courts also usually have held that corporations have authority to grant reasonable bonuses to employees (as distinguished from officers and directors).<sup>42</sup> No reason is apparent why the inauguration of a reasonable and comprehensive bonus plan covering all employees, including executives, should not be an authorized corporate activity. Both bonuses and pensions, theoretically at least, have a favorable effect on employee morale. At the same time, pensions have at least one function (from the viewpoint of the corporation, a vital function) which is not shared by bonuses: to state the obvious, pensions remove the superannuated.

An examination of the English cases and of the more recent American decisions reveals that recognition of corporate authority to grant past service pensions is now widespread. In England, arrangements for the benefit of employees commonly are authorized in the memorandum of association; but the English courts long have sustained, even in the absence of a stipulation in the memorandum, corporate authority to give pensions to retiring employees. In fact, the English courts permit a corporation to grant individual pensions on a discretionary man-by-man basis. As early as 1832, in *Clarke v. Imperial Gas Light and Coke Co.*,<sup>43</sup> an English court upheld the authority of a corporation to grant a pension to a clerk in bad health on his undertaking to abstain from acts prejudicial to the company. In that case the memorandum of association did not mention the granting of pensions. Later English cases fully support corporate authority to award pensions to retiring employees as long as pensions are not expressly prohibited by the memorandum of association.<sup>44</sup> One reason for a difference between the attitude of the English courts and that manifested by the American courts in the early cases is that the practice of giving pensions prevailed in England many years before it became current in this country. Long prior to 1900 many types of English companies would have been under a grave competitive handicap in the labor market if they could not have given pensions to retiring employees.<sup>45</sup> It is worthy of note that neither in *Beers v. New York Life Insurance Co.*<sup>46</sup> nor in *Alexander v. Equitable Life Assurance Society*<sup>47</sup> was

42. *Joy v. Ditto, Inc.*, 356 Ill. 348, 190 N. E. 671 (1934); *Neff v. Gas & Electric Shop*, 232 Ky. 66, 22 S. W. 2d 265 (1929); *Steeple v. Max Kuner Co.*, 121 Wash. 47, 208 Pac. 44 (1922).

43. 4 B. & Ad. 315, 110 Eng. Rep. 473 (K. B. 1832).

44. *Henderson v. Bank of Australasia*, 40 Ch. D. 170 (1888); *Yates v. Cyclists' Touring Club*, 24 T. L. R. 581 (1908); *Normandy v. Ind, Coope & Co., Ltd.*, [1908] 1 Ch. 84; *cf. In re Lee, Behrens and Company, Ltd.*, [1932] 2 Ch. 46. "I entertain no doubt that it is within the powers of the executive of a trading company, unless expressly prohibited, to grant a pension to a retiring officer or servant, and to do that with or without any reasonable terms which may be bargained for or imposed." Kekewich, J., in *Normandy v. Ind, Coope & Co.*, [1908] 1 Ch. 84, 104-5.

45. See *Henderson v. Bank of Australasia*, 40 Ch. D. 170 (1888).

46. 66 Hun 75, 20 N. Y. Supp. 788 (Sup. Ct. 1892).

47. 233 N. Y. 300, 135 N. E. 509 (1922).

evidence introduced to show a custom among insurance companies to grant pensions.

Only since 1940 have American courts indicated with any definiteness that they will uphold the authority of corporations to grant past service benefits. In an unreported case, *Acker v. MacDonald*,<sup>48</sup> the Supreme Court of New York County, New York, approved a pension plan which gave credit for services rendered prior to the plan's establishment. The court, enumerating numerous benefits resulting to the corporation from a pension plan,<sup>49</sup> held the provision of additional retirement allowances in the form of past service benefits to be a justified corporate expenditure and a reasonable, proper and customary method of accomplishing the systematic retirement of superannuated employees. In *Meyers v. Cowdin*,<sup>50</sup> a suit by minority stockholders to recover sums paid pursuant to a retirement plan and to obtain other relief, the Supreme Court of Westchester County, New York, approved a corporate pension plan which included a purchase of past service annuities. The court stated that the plan, even in so far as it contemplated payment of annuities to the employees at or above retirement age, had a legitimate relationship to corporate activity.<sup>51</sup> On appeal the decision was affirmed in memorandum decisions by the Appellate Division and the Court of Appeals.

Other courts since 1940 have considered the question of corporate authority to give past service pensions. In *Nemser v. Aviation Corporation*<sup>52</sup> a stockholder brought suit to enjoin the corporation from putting an annuity plan into operation. The plan provided that on attaining retirement age employees receiving base pay of \$4,200 or more a year were to receive pensions (varying in amount according to salary) if they had made monthly contributions (varying in amount according to salary) to a pension fund. The corporation was to contribute whatever additional amount was necessary to purchase the indicated annuity for each employee.<sup>53</sup> The court upheld the plan but limited its holding by stating: "If . . . the amount of the reward were determined by the length of past services alone, I have grave doubt if the plan would be valid because the consideration supplied by the employee who is to receive the pension would be largely, if not completely, in the past,

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48. N. Y. Co. Sup. Ct., 4-26-40 (not officially reported), P-H PENSION & PROFIT SHARING SERV. § 2164 (1948).

49. "The payment of retirement allowances measured by past services to those employees at or above retirement age or too near retirement age to achieve an adequate allowance otherwise, is not an additional payment for services, previously rendered, or a gratuity, but is a justified expenditure from the point of view of the corporation in that it removes superannuated employees, reduces payroll, improves the morale and efficiency of the younger employees remaining in the employ, attracts better employees, and benefits the relations between the corporation and the public." *Ibid.*

50. 47 N. Y. S. 2d 471 (Sup. Ct. 1944), *aff'd mem.*, 270 App. Div. 827, 60 N. Y. S. 2d 129 (2d Dep't 1946), *aff'd mem.*, 296 N. Y. 755, 70 N. E. 2d 555 (1946).

51. 47 N. Y. S. 2d at 477.

52. 47 F. Supp. 515 (D. Del. 1942).

53. See Chart of Employee Contributions and Corporate Pension Payments, 47 F. Supp. at 517.

and such payments would constitute a gift.”<sup>54</sup> This dictum is subject to criticism because inquiry should have been made whether the corporation would benefit by the pension payment and whether the pension payments were reasonably related to the achievement of contemplated objectives, not whether each employee was rendering a *quid pro quo*. In determining whether a corporation has authority to provide past service benefits, the approach should not be from the viewpoint of what an individual employee gives for the payments. The language used by the court casts considerable doubt on the legality of past service benefits in the many recent pension systems which provide that past service benefits are to be computed on a basis separate and distinct from that used to calculate future service pensions.

In *Osborne v. United Gas Improvement Co.*,<sup>55</sup> minority stockholders filed a bill in equity against the corporation, its president, and its secretary-treasurer to enjoin them from putting into effect a proposed pension plan. Two of the principal challenges to the plan were: (1) the initial payment to be made to an insurance company for the funding of the plan covered the insurance of benefits calculated on past tenure and therefore constituted an illegal payment of compensation for past service; (2) under the Pennsylvania Business Corporation Law outlays to fund pensions can be paid by a corporation only out of current earnings, not out of earned surplus. The pertinent section of the Pennsylvania statute provides that “every business corporation may grant allowances or pensions out of the earnings of the corporation to its directors, officers, or employees for faithful and long-continued service, who have, in such service, become old, infirm, or disabled.”<sup>56</sup> The court held that (1) the statute authorizes a corporation to establish a pension plan on a basis that reflects past service as well as future service, and (2) insurance premiums for the past service annuities can be paid out of earned surplus since the word “earnings” in the statute embraces “earned surplus” as well as “current earnings.”

The inclination of courts in recent decisions to sustain corporate authority to establish pension systems providing past service benefits unquestionably has been occasioned in part at least by prevailing business practices. By far the majority of modern pension plans, probably more than three-fourths,<sup>57</sup> give credit for past service.<sup>58</sup> A casual examination of many plans may not reveal that past service credit is being given, for the plans may not refer to “past service” credit as such.<sup>59</sup> Some plans determine the amount of

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54. 47 F. Supp. at 518.

55. 354 Pa. 57, 46 A. 2d 208 (1946).

56. PA. BUS. CORP. LAW § 316 (1933), as quoted in *Osborne v. United Gas Improvement Co.*, 354 Pa. 57, 46 A. 2d 208, 211 (1946).

57. O'NEILL, MODERN PENSION PLANS: PRINCIPLES AND PRACTICES 277-84 (1947).

58. See LATIMER AND TUFEL, TRENDS IN INDUSTRIAL PENSIONS, Table 15 (1940).

59. Until contributory pension plans became popular, no necessity existed for distinguishing between services rendered before and services rendered after the establishment

pension to be paid by multiplying the retiring employee's total years of service (including service prior to the effective date of the plan) by a certain percentage of his salary. This method of computing pensions of course gives credit for past service. Other plans grant definitely scheduled sums to employees classified by compensation-groups but require a certain number of years of service to qualify for the benefits. Years of service rendered prior to the establishment of the plan usually are counted. Finally, some plans of the contributory type (plans in which employees contribute to pension costs) require the employer to pay toward the funding of each employee's pension a sum equivalent to the amount which the employee would have contributed had the plan been in operation at the time he entered the company's service. These methods and others are used to calculate pensions, but a careful analysis of any modern pension plan almost invariably will show that some credit is given for past service. Several of the pension plans which have been upheld by the courts as future service systems actually contained past service features.<sup>60</sup>

Acceptance of the view that a corporation has authority to install a retirement system that gives credit for past service is inescapable. The legal principles regulating the award of pensions, if they are properly to perform their function, must be adjusted to the technical considerations involved in a workable retirement program. A pension plan to be effective must grant retirement benefits of not less than thirty to thirty-five per cent of final pay; preferably it should provide as much as fifty per cent. Unless pensions of that size are awarded, superannuated workers will remain in service.

Pension systems usually are inaugurated years after the establishment of the business. Employees will have been in service for varying periods of time. Those employees eligible to retire when the plan goes into effect or soon thereafter will not have had time to accumulate sufficient future service credit to provide an adequate pension. Past service benefits therefore are necessary to make retirement possible, both immediately and until accumulations under the future service provisions will provide adequate benefits.<sup>61</sup>

A pension system which fails to give credit for past service is likely to impair rather than to improve employee morale. Older employees will feel that the plan discriminates against them. Naturally they will become disgruntled and will be inclined to stir up trouble among the younger men.<sup>62</sup>

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of the plan. A contributory plan, however, if it is to be financially sound, must be based on principles of accumulation of reserves as the service is rendered. Furthermore, present employees should not be required to share the burden of providing retirement income to older employees for whom no reserves have been accumulated.

60. For instance, an analysis of the plans considered in the following cases reveals hidden past service credits: *Heinz v. National Bank of Commerce*, 237 Fed. 942 (C. C. A. 8th 1916); *Wilson v. Rudolph Wurlitzer Co.*, 48 Ohio App. 450, 194 N. E. 441 (1934); *Schofield v. Zion's Co-Op. Mercantile Institution*, 85 Utah 281, 39 P. 2d 342 (1934).

61. See *Osborne v. United Gas Improvement Co.*, 354 Pa. 57, 46 A. 2d 208, 211 (1946).

62. For additional arguments in favor of recognizing corporate authority to grant



Further, the older employees will remain in service and thus prevent the promotion of deserving young men.

Mr. George T. Washington in 1942 accurately predicted that the rule against the granting of past service pensions would be relaxed.<sup>63</sup> Among the reasons listed to support this conclusion were the following: (1) English courts permit the granting of past service pensions by corporations; (2) American courts allow municipal corporations to grant pensions based largely or almost entirely on past services, in the face of constitutional prohibitions against gifts of public funds; (3) the Internal Revenue Code contemplates past service pension grants by corporations; (4) the courts and the Board of Tax Appeals, in dealing with past service pension plans for tax purposes, have not indicated disapproval of such plans but rather the contrary; (5) the courts seem increasingly willing to support a pension grant if the person pensioned has made some new promise or has furnished some other added consideration.<sup>64</sup> The reasoning on which Washington based his conclusions is as convincing now as it was in 1942. No serious question can exist that the authority of corporations to establish reasonable pension systems providing both future service and past service benefits will soon gain practically universal approval.

#### IV. GENERAL LIMITATIONS ON CORPORATE AUTHORITY TO ESTABLISH PENSION SYSTEMS

The position has been taken in this article that existing social and economic forces compel recognition of an authority in corporations to establish pension systems. If the existence of that authority is accepted, it seems clear that directors and majority stockholders<sup>65</sup> rightly should have considerable discretion in determining the kind of pension system to be inaugurated;<sup>66</sup> and that generally a pension system formulated by the directors and approved by a majority of the stockholders could be established over the objections of minority stockholders. Yet, the power of the directors and of the majority stockholders is, and should be, subject to reasonable limitations.

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past service compensation, see Dix, *Retirement Allowance and Pension Plans of Private Corporations*, 31 GEO. L. J. 22, 32-33 (1942).

63. WASHINGTON, *CORPORATE EXECUTIVES' COMPENSATION* 138 (1942).

64. This willingness of present-day courts to find this kind of support for pensions differs from the attitude of the New York court in *Beers v. New York Life Ins. Co.*, 66 Hun 75, 20 N. Y. Supp. 788 (Sup. Ct. 1892). In the *Beers* case the person claiming the pension had undertaken to render additional services to the corporation.

65. For a discussion of whether approval of a plan at a stockholder's meeting is necessary to its adoption see pp. 374-76 *infra*.

66. "The appellants' argument based on the fact that the large initial premium (on the funding insurance), required in the first year of the plan's institution because of the inclusion therein of pension benefits for past services, 'exceeds the total net income applicable to dividends for common stockholders in the year in which the [premium] payment is to be made' related to matter addressable to the *stockholders*. . . ." *Osborne v. United Gas Improvement Co.*, 354 Pa. 57, 46 A. 2d 208, 212 (1946).

The restrictions as evolved and stated by the courts are quite vague; it is said that a single stockholder is entitled to object if the pension system results in "spoliation" or "waste" of corporate property.<sup>67</sup> Further, the courts have indicated that the purpose of a plan must be to promote corporate interests and that the plan must be reasonably adapted to the attainment of corporate objectives.<sup>68</sup> Unless a plan tends to benefit the corporation, its establishment is *ultra vires*. This principle is illustrated by the cases holding that pensions granted in contemplation of a discontinuance of the business are invalid since payments under such circumstances cannot conceivably promote corporate interests.<sup>69</sup> The plan, of course, must be established in good faith and not as "a mere cloak to some illegal or fraudulent act."<sup>70</sup>

The United States District Court for the District of Delaware has stated that pension payments must bear some reasonable relationship to the value of the services rendered by the employees.<sup>71</sup> The court indicated that minority stockholders could prevent the installation of a pension plan if payments thereunder were not so related because the payments "would constitute a gift, and not even the majority of stockholders have the right to make gifts over the protest of even a small minority."<sup>72</sup> Perhaps the court should have inquired into the relationship between the pension payments and the achievement of corporate objectives rather than into the relation of those payments to services rendered by the pensioned employees. Under the standard laid down by the court, most modern plans would not be subject to successful attack; they take into account both an employee's compensation and his length of service. A few plans, however, grant identical pensions to all employees irrespective of their salaries or their length of service; under the literal language of the court, these plans would seem to be illegal. Probably

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67. *Fogelson v. American Woolen Co.*, 170 F. 2d 660 (C. C. A. 2d 1948). Unless the corporation benefits by an expenditure, it is *ultra vires*. Not even a majority of stockholders can sanction a waste of corporate assets. *Rogers v. Hill*, 289 U. S. 582, 53 Sup. Ct. 731, 77 L. Ed. 1385 (1933).

68. *Fogelson v. American Woolen Co.*, 170 F. 2d 660 (C. C. A. 2d 1948). "[Corporate] money can only be spent for purposes reasonably incidental to the carrying on of the company's business, and the validity of such grants is to be tested, as is shown in all the authorities, by the answers to three pertinent questions: (i.) Is the transaction reasonably incidental to the carrying on of the company's business? (ii.) Is it a bona fide transaction? and (iii.) Is it done for the benefit and to promote the prosperity of the company?" *In re Lee, Behrens & Company*, [1932] 2 Ch. 46, 51.

69. Handy, *Private Pension Plans and the Federal Revenue Act*, 16 N. Y. U. L. Q. REV. 408, 411 (1939) and authorities there cited; cf. *In re Lee, Behrens and Company*, [1932] 2 Ch. 46.

70. *Heinz v. National Bank of Commerce*, 237 Fed. 942, 953 (C. C. A. 8th 1916).

71. *Nemser v. Aviation Corp.*, 47 F. Supp. 515 (D. Del. 1942); cf. *Fogelson v. American Woolen Co.*, 170 F. 2d 660 (C. C. A. 2d 1948); *Neff v. Gas & Electric Shop*, 232 Ky. 66, 22 S. W. 2d 265 (1929) (bonuses). Note also the following language from *Scott v. P. Lorillard Co.*, 108 N. J. Eq. 153, 154 Atl. 515, 516 (1931), setting forth the circumstances in which employees can participate in a bonus scheme: "Officers and employees might participate in a bonus in proportion to their salaries, or the length of their service with the corporation, or in accordance with the quality of their work or the results produced by them, or in some other manner related to the employment."

72. *Nemser v. Aviation Corp.*, 47 F. Supp. 515, 517 (D. Del. 1942).

the court in stating the rule had in mind its application as a safeguard against the award of disproportionate pensions to executives. It is hardly conceivable that a modern court would refuse to sustain plans granting pensions in the same amount to all employees.

#### V. PENSION SYSTEMS WHICH INCLUDE EXECUTIVES OR DIRECTORS AMONG THE BENEFICIARIES

Stockholder attacks on pension systems most frequently are directed against pension provisions covering company executives. In the first place, a large portion of the expenditures for pensions, particularly for the initial funding of past service benefits, usually goes to provide pensions for executives. As has been pointed out,<sup>73</sup> most pensions are related to compensation and length of service. The executives usually have been with the company for a long period of time and of course their compensation is ordinarily many times that of the average employee. When stockholders become aware of the size of pensions scheduled for the executives they are likely to offer resistance; they cannot see how the benefit to the corporation could be commensurate with the size of the pension payments. Further, pension systems, because of their intricacies, are particularly subject to abuse. Too often corporate executives have looked upon pension systems as devices to siphon off corporate profits long after they have ceased to render useful services to the corporation. Naturally, minority stockholders often contest expenditures for executives' pensions.

Strong arguments exist for recognizing the validity of reasonable pensions for executives. The success of a company usually depends largely on the decisions of the men in executive positions. Inefficiency among those making policy determinations is much more harmful to a company than inefficiency among personnel with lesser responsibilities. At the same time, superannuation among executives is likely to be much greater than among workers. In short, the removal of aged executives ordinarily is a more pressing problem to a corporation than the retirement of superannuated wage earners.

And executives, like the workers, cannot be retired without pensions. Expenses connected with their station prevent any considerable saving. During their productive years they adopt high standards of living and assume fixed commitments. Because of high personal income taxes and low interest rates, the managerial group now find it difficult, by methods of accumulation available prior to 1929, to build up a reserve sufficient to produce an adequate income.

Social security legislation alleviates the insecurity of the workers. Similar

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73. P. 353 *supra*.

protection has not been provided for the executives; yet insecurity affects the morale of executives as much, perhaps more, than it does the morale of the workers. As was said by the court in *Holmes v. Republic Steel Corporation*,<sup>74</sup> "The same mental process and the same human emotions govern the man in the office and the man in the mill. A corporation would be shortsighted which sought to make its laborers and clerks satisfied and happy employees, and neglected its key men and executives."

The morale of the younger executives will suffer if the policy of a company is to retire its executives without pensions, and potential executives will not be interested in seeking a life career with the company. The facts also cannot be overlooked that key executives usually control a company and that as a practical matter they cannot be displaced until they are ready to relinquish their positions.

Many of the first corporate pension systems to be upheld by the courts included executives in their coverage. In the leading case of *Heinz v. National Bank of Commerce*,<sup>75</sup> a stockholder in a banking corporation brought suit in equity to compel a former president to refund \$50,000 which the bank had paid him on retirement. The bank had paid that amount in consideration of his waiving his rights to participate under a pension plan, of his waiving his salary for the remainder of the year in which he retired, and of his undertaking not to enter the employ of another bank. The court recognized the authority of corporations to establish pension systems "in proper cases and under proper circumstances."<sup>76</sup> Unquestionably the court felt that the provisions of the plan under which the president was to receive benefits were proper, since it held that he had a valid claim for a pension and that therefore the agreement to pay him \$50,000 was valid as a compromise of a pension claim. The more recent cases leave little doubt that modern courts will uphold corporate authority to establish pension systems which provide reasonable pensions for executives.<sup>77</sup> Finally, the trend in legislation seems to be toward a recognition of such authority.<sup>78</sup>

To induce retirement, pension payments to executives must be larger than those to lesser employees. An effective pension plan must give consideration to standards of living in fixing the size of pensions. Ordinarily pension payments should be computed in part at least on a salary basis. The customary procedure of multiplying years of service by a percentage of salary as a rule serves quite adequately.

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74. 69 N. E. 2d 396 (Ohio C. P. 1946).

75. 237 Fed. 942 (C. C. A. 8th 1916).

76. 237 Fed. at 953.

77. *Nemser v. Aviation Corp.*, 47 F. Supp. 515 (D. Del. 1942); *Holmes v. Republic Steel Corp.*, 69 N. E. 2d 396 (Ohio C. P. 1946).

78. PA. BUS. CORP. LAW § 316 (1933), as quoted in *Osborne v. United Gas Improvement Co.*, 354 Pa. 57, 46 A. 2d 208, 211 (1946); N. J. REV. STAT., tit. 15, c. 9, art. 1 (1937), as interpreted by *Holmes v. Republic Steel Corp.*, 69 N. E. 2d 396 (Ohio C. P. 1946).

Until recent years the prevailing practice was to place a dollar maximum on pensions; and some major insurance companies still limit the size of annuities which can become payable under systems funded with them.<sup>79</sup> The present trend, however, seems to be away from the prescribing of pension maximums. A recent case, *Fogelson v. American Woolen Co.*,<sup>80</sup> may reverse that trend. In that case, a pension system, which was to go into effect on January 1, 1948, set up a formula for determining pensions which took into account an employee's salary and his length of service both before and after the effective date of the plan. The plan would have so operated that on June 1, 1949, the president of the corporation would have become eligible to retire and to receive an annual pension of \$54,220. The next largest pension would have been only \$7,285. Minority stockholders brought suit against the corporation and its directors to enjoin them from putting the plan into operation. The plaintiffs contended that the pension to be paid the president was "excessive and unconscionable" and that the failure to set a reasonable ceiling in dollars on the pension that could be paid a single individual constituted a waste of corporate assets. The defendants moved for summary judgment on the ground that the complaint failed to state a claim upon which relief could be granted, since the plaintiffs sought to enjoin corporate action on a matter of internal management in respect to which the business judgment of the directors was conclusive. The district judge granted the motion, expressing the opinion that no "colorable" reason existed for disturbing the exercise of the directors' judgment and discretion. On appeal, the United States Circuit Court of Appeals for the Second Circuit reversed the judgment and remanded the case for trial. The court felt that in view of the nearness of the president to retirement, the size of the pension he was to receive, and the disparity between his pension and the next largest pension, a "justiciable inquiry" was raised and that the issue whether the pension amounted to "spoliation" or "waste" should have been tried.<sup>81</sup>

Pension systems have been upheld even though they provided for the computation of executives' pensions on a different basis from the one used to determine pensions for other employees. For example, the pension system sustained in *Holmes v. Republic Steel Corporation*<sup>82</sup> did not use the same method to calculate executives' pensions as it did to calculate the pensions of other employees. Under that system, employees were required to contribute forty per cent of the annual premiums necessary to purchase their annuity

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79. O'NEILL, MODERN PENSION PLANS: PRINCIPLES AND PRACTICES 130 (1947).

80. 170 F. 2d 660 (C. C. A. 2d 1948).

81. "We do not say that a pension of \$54,220 to such an officer cannot be justified, but, if justified, it must be because it is in the interest of the employer to insure to even those who receive so high a salary that they may retire on a pension computed upon the same percentage formula as the lowest salaried employees." *Fogelson v. American Woolen Co.*, 170 F. 2d 660, 663 (C. C. A. 2d 1948).

82. 69 N. E. 2d 396 (Ohio C. P. 1946).

contracts. The corporation, provided its expenditures would not exceed a sum equal to nine per cent of its payroll, was to furnish the remainder. On the other hand, the corporation undertook to pay the full cost of pensions for certain key executives. The pensions, however, were not to exceed three per cent of each officer's present salary for each year of his past and future service.

In *Nemser v. Aviation Corporation*,<sup>83</sup> a stockholder brought suit to enjoin the corporation from putting into effect a pension plan covering employees receiving a base pay of \$4,200 or more. The plan provided annuities for employees on their attaining age 65 if male or age 60 if female. The annuities were to vary in amount by salary classifications.<sup>84</sup> The employees were to make monthly contributions toward the cost of the annuities, the size of their contributions also to vary by salary classes. The more highly paid employees were to contribute not only a larger net amount than the employees in the lower pay grades but also a larger *proportion* of their salaries. The effect of the plan was to require the corporation to put out for each annuity an amount approximately three times as great as the amount contributed by the employee. The stockholders attacked the plan on the ground that it would result in a waste of corporate assets, because (1) payments were to bear no relation whatsoever "to the nature, character or extent of the services rendered or to be rendered" by the beneficiaries, and because (2) the plan was unfair and inequitable in that beneficiaries were limited to officers and employees in the higher income brackets. The court held the plan to be valid, stating simply that the respective payments authorized by the plan had a "reasonable relation" to the value of services rendered by the employees.<sup>85</sup> It may be doubted whether the court really understood the operation of the plan and the extent to which it was weighted in favor of executives. The amount to be spent by the corporation for the purchase of each executive's pension was proportionately as well as quantitatively greater than the amount the corporation was to spend on the pension of a lesser employee. In addition, the ratio of an executive's pension to his salary would be greater than the ratio of an employee's pension to an employee's salary. Finally, the plan, it is to be remembered, did not apply at all to employees earning less than \$4,200 a year. In fairness to the court, however, the points should be made that (1) the insecurity of many of the employees earning less than \$4,200 a year was ameliorated by the social security laws<sup>86</sup> and

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83. 47 F. Supp. 515 (D. Del. 1942).

84. See contribution and retirement income schedule, 47 F. Supp. at 517.

85. "The pension contemplated by the present plan has, I believe, a reasonable relation not only to the value of the services rendered in the past but also to be rendered in the future." 47 F. Supp. at 518.

86. Between 1936 and 1945 a considerable number of plans were adopted which limited retirement benefits to (1) employees earning in excess of \$3,000 per year, or (2) salaried employees as distinguished from hourly paid and wage employees. Lipton,

that (2) a difference of opinion reasonably could exist on whether the employees who were not included in the plan and the employees in the lower pay groups covered by the plan were financially able to allocate any appreciable portion of their salaries to the purchase of annuities.

Courts must be alert to uncover schemes by unprincipled executives to pervert pension systems and use them as instruments to achieve improper ends. The top executives, as a practical matter, often have almost complete control of the corporation. Naturally they tend to look with favor on a pension system when they themselves are approaching the age of retirement. A large portion of corporate pension plans, as a matter of fact, have been adopted when influential executives were nearing the retirement age. Probably the motives of interested executives in throwing their support to the establishment of pension systems have not always been improper; nearness to the problems of old age merely may have made the executives more aware of the desirability of providing security for aged employees. Yet very real dangers exist that some executives will take advantage of their control of the corporation to secure the adoption of pension systems which will discriminate in favor of executives and highly paid employees or which will impose an unreasonably heavy burden on the corporation.

One of the greatest dangers is that a pension system will be inaugurated, left in effect just long enough for executives' pensions to be funded, and soon thereafter abandoned. A group of corporate executives, during a period of prosperity, may secure the adoption of a pension plan that provides for liberal pensions. The executives well may be aware that the corporation can not continue to pay such liberal pensions indefinitely. Provision may be made to fund past service annuities from profits and earned surplus. An argument easily could be made that the cost to the corporation of such annuities would be less if they were paid for at the time the plan is put into effect. Yet, the result is that the executives who retire soon after the pension plan goes into effect are assured of receiving large pensions while employees scheduled to retire at a later date may find their pensions greatly reduced or even wiped out entirely because of a weakening of the corporation's financial position.

Quite often expenditures to fund past service credits are spread over a period of years. Most of the employer's annual past service contribution customarily is applied toward the complete funding of the past service credits of those persons nearest retirement; the remainder of the contribution, if any, may be applied either to the credit of the other past service annuity accounts or to the accounts of the group next nearest retirement. In other words, in the event of the early termination of the plan, the past service credits of older employees (and how often they include the executives!) may be funded

completely while no funds at all will have been expended to fund the past service annuities of other employees.

The Commissioner of Internal Revenue, in determining whether pension systems are to be "approved" and permitted to enjoy the advantages set forth in section 165(a) of the Internal Revenue Code, has recognized that a pension system which does not have "the character of permanence" can easily be used as a device to discriminate in favor of officers, shareholder-employees, or highly compensated employees.<sup>87</sup> The position of the Commissioner is that the term "plan" implies a permanent program. The Commissioner will approve a plan even though the employer reserves the power to modify or terminate the plan or to cease contributions thereunder; for a reservation of the power to change or terminate pensions is a wise safeguard to avoid the possibility that at some future time the corporation will find itself saddled with obligations it cannot meet. At the same time, the Bureau takes the position that the abandonment of a plan within a few years after it is put into operation for any cause other than business necessity is evidence that the plan from its inception was not a *bona fide* pension program. Perhaps the courts could derive considerable profit from a study of the experiences of the Commissioner in dealing with pension plans.<sup>88</sup>

Executives are fiduciaries and have a heavy responsibility to stockholders and creditors. More reason exists to exercise a careful scrutiny of pension payments made to executives than of pensions paid to lesser employees.<sup>89</sup> Often the executives are also directors. Where the beneficiary of a pension is an officer or director, he should have the burden of proving the reasonableness and fairness of the pension.<sup>90</sup> Provisions in pension plans providing for

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87. Courts often are influenced to declare a plan to be valid by the fact that the Commissioner of Internal Revenue has "approved" it as meeting the requirements of INT. REV. CODE § 165(a). See, for instance, *Fogelson v. American Woolen Co.*, 79 F. Supp. 291, 294 (S. D. N. Y. 1948), *rev'd* 170 F. 2d 660 (C. C. A. 2d 1948).

88. The proper approach for a corporation to take in establishing a pension system is illustrated in the following excerpt from a booklet entitled "Retirement Income Plan," distributed to employees by the Market Street National Bank of Philadelphia: "The Bank hopes and expects to continue the plan indefinitely, and every effort has been made to arrange the plan so that it will meet future conditions insofar as they can be foreseen. In order to protect members and the Bank against unforeseen conditions, however, the right to change, amend or discontinue the plan is necessarily reserved by the Bank. Despite this reservation, no change or discontinuance for any reason can adversely affect the retirement incomes purchased prior to the date of such change or discontinuance and then in force.

"Pursuant to the requirements of the Commissioner of Internal Revenue in connection with the qualification of pension plans, the group annuity contract will provide for a limitation of the retirement income benefits of certain of the highest paid members if the plan should be discontinued its first ten years, or during such longer period as may apply as a result of certain types of modification or suspension of the plan. Any member who may be affected by these limitations will be individually notified." (P. 7.)

89. WASHINGTON, CORPORATE EXECUTIVES' COMPENSATION 140 (1942).

90. *Dix, Retirement Allowance and Pension Plans of Private Corporations*, 31 GEO. L. J. 22, 26 (1942). But see *Heinz v. National Bank of Commerce*, 237 Fed. 942, 953 (C. C. A. 8th 1916), where the court said: "The burden [rests] upon the appellant [protesting stockholder] to show the invalidity of the action taken by the stockholders in



executives' pensions should be tested twice: first, by the technical rules dealing with the existence of corporate authority; second, by rules analogous to those governing the exercise of a trustee's authority.

#### VI. PROCEDURE TO BE FOLLOWED IN ADOPTING A PENSION SYSTEM

Minority stockholders sometimes claim that proper corporate representatives did not participate in the adoption of a plan or that acts purporting to adopt it were ineffective because of some defect in the procedure followed. If a plan has been approved only by the board of directors, minority stockholders may assert that the board did not have authority to embark on such a costly, long-range program without stockholder consent. And, even if the plan has been approved at a meeting of the stockholders, minority interests still may claim that the action taken by the stockholders was invalid because proper notice of the meeting was not given, because proxies were secured by improper methods, or because pertinent information about the plan was not disclosed to the stockholders.

The question of what corporate representatives have power to act for the corporation in establishing a pension plan is one to which the authorities give no definitive answer. To be sure, the state corporation laws or a corporation's articles or by-laws could provide either that the directors would have authority to set up a pension system or that a pension system could not be installed without action by the stockholders. Actually, however, the corporation laws of most states and the articles and by-laws of most corporations are silent in respect to this question. And as yet the courts have not worked out rules to apply in the absence of statutory, charter or by-law provisions.

Corporation laws of course vest the general management of corporate affairs in the board of directors. The authority of the board over the ordinary business of the corporation normally is exclusive.<sup>91</sup> On the other hand, corporation statutes ordinarily provide that extraordinary and unusual changes in the corporation must be approved (usually by some specified majority vote) by the stockholders. For example, the stockholders must approve an increase in the authorized number of shares, a change in the capital stock, amendments to the articles of incorporation, a merger or consolidation with another corporation, or a voluntary dissolution of the corporation.<sup>92</sup>

Perhaps a reasonable argument can be made that, in the absence of a contrary statutory, charter or by-law provision, the inauguration and operation of a pension system should be considered a function of the board of directors. Generally the directors have authority to take any reasonable action

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establishing the pension fund, or the invalidity of the action taken by the board of directors in reference to Edwards' claim to a pension."

91. STEVENS, CORPORATIONS 544-50 (1936).

92. BALLANTINE, CORPORATIONS 643 (2d ed. 1946).

to improve personnel efficiency and morale. For instance, the board of directors has authority to grant salary increases, to give bonuses in proper cases, to permit sick leaves, and to allow paid vacations. The installation of a pension system is intended to achieve the same objective as the activities mentioned. In short, since the board undeniably has authority to determine the character and amount of compensation to be paid to employees, some reason exists for asserting that the board should also have authority to perform an analogous act, the establishment of a pension system.

But not a single case has been found in which the court squarely held the board of directors to have authority by unilateral act to install a pension system. Dictum in an early English case, *Clarke v. The Imperial Gas Light and Coke Company*,<sup>93</sup> indicates that the court was of the opinion that the board of directors has authority to award a pension.<sup>94</sup> Even in that case, however, the court had in mind the granting of a single pension, not the establishment of a pension system with its concomitant long-term undertakings.<sup>95</sup>

On the other hand, apparently no case has held that the stockholders must approve the establishment of pension systems. Perhaps language in one or two decisions intimates that the stockholders are the proper representatives of the corporation to act on pension plans, but a definite holding, or, for that matter, even a clear-cut statement, does not seem to have been made. In the absence of authority, the large expenditures and the permanent nature of commitments involved suggest the desirability of requiring stockholder approval.

The usual practice, perhaps because of uncertainty whether the directors or stockholders should act, is for the directors to formulate a plan, to pass a resolution adopting it, and then to submit the plan to the stockholders for approval. Unquestionably the fact that a plan has been approved at a stockholders' meeting weakens the force of an attack by minority interests. If any of the directors are beneficiaries, approval by the stockholders is especially important. Unless a disinterested quorum of the directors are present and a disinterested majority vote for a resolution on a matter in which one or more of the directors has a personal interest, the rule in many states is that action

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93. 4 B. & Ad. 315, 325, 110 Eng. Rep. 473, 477 (K. B. 1832). See also *Yates v. Cyclists' Touring Club*, 24 T. L. R. 581 (1908).

94. But in *Beers v. New York Life Insurance Co.*, 66 Hun 75, 20 N. Y. Supp. 788 (Sup. Ct. 1892), one of the grounds the court advanced for not upholding a pension granted to the president by the board of trustees was that the trustees could not bind the corporation beyond their term of office.

95. "We are, however, of opinion that the general authority confided to the directors to manage the concerns of the company may well authorize a grant like this, particularly to an officer entitled to a salary, wishing to retire on account of ill health, and agreeing to abstain from transferring his services to any other company." 4 B. & Ad. at 325, 110 Eng. Rep. at 477. The president or other corporation officers ordinarily do not have authority to grant even an individual pension. *Plowman v. Indian Refining Co.*, 20 F. Supp. 1 (E. D. Ill. 1937); *Langer v. Superior Steel Corp.*, 318 Pa. 490, 178 Atl. 490 (1935); *Magnolia Petroleum Co. v. Butler*, 86 S. W. 2d 258 (Tex. Civ. App. 1935). But see *Southern Hide Company v. Best*, 174 La. 748, 141 So. 449 (1932).

taken is voidable. The defect, however, can be cured by a vote of a majority of the stockholders.<sup>96</sup>

Some courts seem to have assumed, without so holding, that ratification at a meeting of the stockholders is necessary to validate a pension system and that a defect in the stockholders' meeting will be fatal to the plan even though it has received the approbation of the directors. Stockholders often challenge a pension plan on the ground that the stockholders' meeting at which the plan purportedly was approved was not properly called, that a quorum was not present at the meeting, that not all material facts about the plan were revealed to the stockholders, or that the proxies voted at the meeting were illegal because of failure to disclose full details to stockholders giving the proxies.

In the absence of statute, stockholders of course can act for the corporation in respect to any matter on which they have authority only at a meeting, duly called upon proper notice, at which a quorum is present.<sup>97</sup> And, if a pension plan is assumed to require stockholder approval, then it would seem clear that the usual rules governing stockholders' meetings apply.

The complaint that minority stockholders most often voice in respect to action taken on a pension plan at a stockholders' meeting is that not all material facts about the plan were disclosed to the stockholders. If misrepresentations as to material facts (such as the cost of the plan, its funding method, or the formula to be used in determining benefits) were made to the stockholders, or if material facts were concealed from them, the action taken at the stockholders' meeting should be held to be invalid. The information most likely to be concealed is of course the participation of officers or directors in pension benefits, the size or cost of their pensions, and the nearness of key personnel to the retirement age. It would appear that where executives or directors are to benefit from a pension plan, the communications disclosing their interest "must lay bare the truth, without ambiguity or reservation, in all its stark significance."<sup>98</sup>

Directors often overcome the objections of the stockholders to the high cost of providing pensions by pleading the needs of old and destitute employees. The cause of aged officers and directors could not be presented to the stockholders quite so convincingly. Good faith, if nothing else, requires the disclosure that a few executives will be sprinkled among the destitute old men

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96. *Godley v. Crandall & Godley Co.*, 212 N. Y. 121, 105 N. E. 818 (1914); *Chamberlain v. Chamberlain, Care & Boyce, Inc.*, 124 Misc. 480, 209 N. Y. Supp. 258 (Sup. Ct. 1925); *Russell v. Henry C. Patterson Co.*, 232 Pa. 113, 81 Atl. 136 (1911).

97. BALLANTINE, CORPORATIONS 390-91 (2d ed. 1946).

98. *Wendt v. Fischer*, 243 N. Y. 439, 443, 154 N. E. 303, 304 (1926). "When they [officers who are also directors] receive a pension based on past services, the grant should be required to meet the most rigid tests of good faith and fair dealing. Certainly the least that can be required is to insist that the grant be made by a disinterested board of directors; that it be fully disclosed to the stockholders; and that they be given a fair opportunity to pass upon it." WASHINGTON, CORPORATE EXECUTIVES' COMPENSATION 140 (1942).

who will receive pensions and that a considerable portion of the cost will be used to purchase pensions for executives.<sup>99</sup>

#### VII. EFFECT OF MINORITY STOCKHOLDERS' FAILURE PROMPTLY TO CONTEST A PENSION SYSTEM

A possible defense that corporations and their directors thus far seem to have overlooked in cases brought by minority stockholders to attack pension systems is that the stockholders may be barred by laches. A convincing argument can be made that stockholders who have stood by while a plan was being put into operation, who have permitted large sums of money to be expended to fund past service benefits, and who have permitted rights to be acquired by numerous employees, should not be permitted to come into court and contend that the plan is *ultra vires* or that some irregularity occurred in its adoption.

No case in which stockholders challenging a pension system were held to be barred by laches has been found, but cases are rather numerous in which stockholders have been held to have lost their rights to object to comparable projects. Certainly, if minority shareholders permit years to elapse after they have knowledge of corporate acts and third parties acquire rights thereunder, the stockholders should be barred from contesting the acts.<sup>100</sup> In *Graff v. Williamsport Water Co.*,<sup>101</sup> for instance, a plan to revise the capital structure of a corporation was formulated by the board of directors during the summer of 1927 and was approved by the stockholders on September 14, 1927. A minority stockholder brought suit to declare the new capital structure invalid on October 17, 1929. The court held that the plaintiff was barred by laches and stated that only the "gravest reasons of public policy" would warrant declaring invalid bonds and stock issued and sold to investors.

Other cases indicate that a stockholder may find himself within a much shorter period of time estopped, or barred by laches, from challenging corporate action.<sup>102</sup> In fact, under certain circumstances, a dissenting shareholder may find within a month after a corporate act that he has lost his right to chal-

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99. Cf. *Holmes v. Republic Steel Corp.*, 69 N. E. 2d 396, 411 (Ohio C. P. 1946), where the court held that the failure to mention the name of a key officer as being one of the "principal executive officers" who would receive a "non-contributing" pension contract, did not affect the validity of the notice given to stockholders who passed on the plan.

100. *Backus-Brooks Co. v. Northern Pac. Ry.*, 21 F. 2d 4, 12-13 (C. C. A. 8th 1927) (delay of more than six years); *Graff v. Williamsport Water Co.*, 312 Pa. 255, 167 Atl. 341 (1933) (delay of more than two years).

101. 312 Pa. 255, 167 Atl. 341 (1933).

102. "To entitle stockholders to relief against the action of a corporation, they must bring suit within such time after the doing of the acts complained of that the court may stop, or undo, the wrong of which they complain, without doing wrong to some other person; or, in other words, if a stockholder wants protection against the consequences of an act of the corporation, he must ask for it with sufficient promptness to enable the court to do justice to him, without doing injustice to innocent third parties." *Boldenweck v. Bullis*, 40 Colo. 253, 90 Pac. 634, 636 (1907).

lence it. In *Windhurst v. Central Leather Co.*,<sup>103</sup> on the day after an amendment to the certificate of incorporation was approved by the stockholders, it was filed with the proper state authorities and securities were issued under it. Less than one month thereafter dissenting stockholders brought suit questioning the validity of the amendment. The court held that the objectors were barred by laches.

In the light of the above-mentioned cases, it would seem that dissenting stockholders incur grave risk of losing their rights to object to a pension system unless they take action within a few days after they learn of a proposal to establish it. Perhaps, even before the plan is approved by the stockholders, the objectors should bring suit against the corporation and its officers to enjoin them from taking further steps to secure its adoption. In *Scott v. P. Lorillard Co.*,<sup>104</sup> the complainants sought to restrain the company and its officers from submitting to a stockholders' meeting a proposed amendment to the by-laws which would have provided for extra dividends on stock owned by officers and employees. The defendants contended that complainants should have waited until after the adoption of the by-law and then sued to restrain payments thereunder. The court held that the complainants' bill had not been filed prematurely, that the procedure they had followed to test the proposed amendment was a proper one.

Objecting stockholders probably would be wise to follow the same procedure in attacking pension plans. In addition to avoiding the risk of finding themselves barred by laches, they would be able to obtain court consideration of a plan before its submission to the stockholders and thus would avoid the psychological barrier created by an approval of it by a majority of the stockholders.

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103. 101 N. J. Eq. 543, 138 Atl. 772 (1927).

104. 108 N. J. Eq. 153, 154 Atl. 515 (1931).