

Republican Journal Supplement.

BELFAST, THURSDAY, MARCH 2, 1882.

To the Citizens of Belfast.

We respectfully submit to your consideration the following statement of our acts as Directors of the B. & M. L. R. R. for the past ten and one-half years. We also ask your careful perusal of the appended legal opinion, by S. C. Strout, Esq., of Portland, acknowledged throughout the state to be one of the ablest lawyers in Maine. For several months past we have been charged with grievous offences if not serious crimes against the rights of the people of Belfast. A proper regard for the opinions of our fellow citizens has induced us to make this publication.

In July 1871, with two exceptions, we were elected Directors of the R. R. Corporation. We were selected by the municipal officers and the vote of the city's shares was cast for us. We were an entirely new board; and knowing something of the involved condition of the corporation, accepted the trust with hesitation. The financial condition of the company was found, deplorable. A large floating debt past due, together with many heavy unadjusted claims were pressing upon the corporation for immediate payment. There was no money in the treasury and no available assets. Over \$200,000 of the preferred and \$50,000 of the non preferred stock, subscribed for had not been taken. Suits were then pending to enforce the payment of subscriptions. With one exception, these suits failed and nothing came from them except heavy bills of costs against the company. Less than \$20,000 from the rental, for the year to come, would be available to pay debts then due. The task before us was a difficult one. The floating debts and claims aggregated at least the large sum of \$200,000. The last cargo of iron had not been paid for. Our citizens, among whom were many of our Directors, had endorsed the Corporation's notes for \$53,500, to meet for the time being, the iron claim. There was a large claim by the contractors, and numerous claims guaranteed by the company on labor and construction account. Pledged securities were held by individuals or banks, requiring large sums of money, or otherwise incurring a heavy sacrifice on the securities pledged. At that time the loan of \$101,900 to the R. R. Co. by the city remained a temporary loan for which no note had been given, and no arrangement for payment made. The policy to be pursued was a matter of great and vital importance. Several lines of policy were suggested and discussed. That adopted by the Directors was deemed by them best, both for the R. R. Co., and the city. It was this:—The giving of time notes in several instances where the claims were definite and certain; among which was one to the city for \$101,900, and several others of smaller amounts; also the hiring of money temporarily to take up pledged securities and holding them for a favorable opportunity, to sell without unnecessary sacrifice. Many other claims were compromised and paid as fast as the receipts of the rental, or the accumulation of some of the directors with their own private funds would allow. This policy was continued for seven years when all the claims and notes, except the note of the city, were liquidated. The note to the city would not become due till 1885. From 1878 to 1885 the interest to be paid from the rental would be \$15,114 annually and there would remain of the rental, after paying it, nearly \$21,000. This sum accumulating each year would be more than sufficient to meet the city's note at maturity. As prudent business men we deemed it our duty to provide from the funds coming to our hands annually, a sinking fund, for meeting the payment of this note when due. This policy of creating a sinking fund has been pursued from 1878 to the present time and twice each year a sum has been added to it, and bonds of the city of Belfast have been bought, of which \$14,000 have been taken by the city, endorsed on the note of the R. R. Co. and cancelled; and the balance of the sinking fund now all in Belfast bonds and amounting to \$19,000, is in the hands of the treasurer of the corporation, who is under \$50,000 bonds for the safe care of it and his other trusts. The policy thus pursued has left a balance in the hands of the treasurer, each six months which has been carried to dividend account. This balance has been declared as a dividend upon the preferred stock, amounting to two and one fourth per cent semi-annually, and has absorbed all the funds carried to dividend account. It will be borne in mind that the city owns more than half of the preferred stock and receives the larger part of this dividend. The Directors believed it their duty, first to provide for the annual interest on the funded debt, the expense of maintaining the organization and for the sinking fund to meet a maturing debt; and until this

was done, there was no money that could be legally used for dividend purposes. When the policy of maintaining the sinking fund should cease then the interest and expense of the organization must first be provided for before there would be money that could be used for dividends.

The Directors believed that "net earnings" for dividends had no other meaning or interpretation than the sum remaining after making the provisions above referred to. This view is confirmed by some of the most prominent railroad men in New England, and is fully sustained by the legal opinion hereto annexed to which your attention has already been called. This course, thus briefly outlined, has been as we supposed acceptable and satisfactory to the stockholders. No protests against it have ever been presented to us; no motions or resolutions proposing a change have ever been made at the meetings of the stockholders; no injunctions have ever been served upon us. On the contrary, at the meeting of the stockholders in 1879 the following resolution, approving our action was unanimously passed:—

"Resolved that it is the opinion of the stockholders that the action of the Directors in declaring a dividend of four and one-half per cent. to the preferred stockholders and reserving the remainder of the net income of the road, as a sinking fund has been wise and for the best interests of the company, and meets with the approval of the stockholders."

Recently new plans have been suggested for the disposal of the rental annually received. In the first number of "The Tax Payer," two plans were set forth, slightly differing, but both suggesting the division of the entire rental of \$36,000, as dividends, giving 6 per cent. to the preferred and 5½ to the non-preferred stockholders. One plan then suggests, for meeting the interest of the funded debt, the retention by the corporation, of \$220 of the dividend of each share of preferred and non-preferred stock; the other suggests, for meeting said interest the retention of a larger portion from the share of the preferred stockholder, making the two classes contribute in the ratio of their dividends or as 6 to 5½. The parties suggesting these plans have failed, as yet, to show in what manner or by what authority, they can, after declaring the dividend, withhold enough of that dividend to meet the interest liability of the corporation. A dividend once declared becomes the property of the stockholder and if not paid as declared he has a right of action for its recovery the same as for any demand due him. There is no way that the property of a stockholder, whether dividend or other property can be taken for the liabilities of the corporation except by assessment, and assessment on stock paid for, is absolutely prohibited by the laws of our State. Either plan would be void in law and neither is in accordance with the spirit and letter of the contract as understood by all the stockholders. Dividends are only declared under the 18th by-law, quoted in the appended opinion. To this by law the stockholders have twice given their interpretation; once at a meeting held January 15th, 1870, and again at a meeting held in July 1878. At the former meeting, held to determine whether to issue mortgage bonds, the stockholders voted to issue \$150,000 in first Mortgage Bonds with interest at six per cent. in gold; they also voted to issue second mortgage bonds "to every person or corporation taking or paying for stock in this company," those to the preferred stockholders should draw 6 per cent. interest, those to the non-preferred to draw the rate per cent. provided in the 18th by law. This action of the stockholders gave their understanding of the by-law and relative rights of the different classes of stock as to dividends, at that time; which was after the payment of the interest on the first mortgage bonds, the preferred stockholder should then receive 6 per cent. and the balance go to the non-preferred or to such other purposes as the same might be needed. Whether this second mortgage was valid or not does not affect the interpretation of the by-law, made at that meeting. The interpretation given at the second meeting, July 1878, was expressed in words in the form of an amendment defining the meaning of "net earnings" as used in the 18th by-law, for dividend purposes, and re-affirming the interpretation of the former meeting. At both of these meetings the vote for the city's stock was cast in favor of the action then taken, and represented 5000 out of 5124 shares voting at the first meeting and about the same at the second. The Directors believing this interpretation accurate, have followed it. The illustration used in "The Tax Payer" to sustain the second plan therein suggested, is that of "jetson" at sea, or the throwing over a portion of the cargo or equipment to save the remainder. In this there is an absolute loss of the part thrown or cut

a way, from property belonging to vessel and cargo, and a legal right remains to assess both that the loss may be borne equally; while in the case of the railroad there was no loss of either preferred or non-preferred stock or of property in any way by the issue of mortgage bonds, but rather the addition of property to that already paid for by the stock, and which now exists as a portion of the property of the corporation earning, like the rest of the property, its relative share of the rental; and another difference is, there is no legal or possible right remaining to assess the stockholder for this added property.

It is to be understood that the publication of this statement is not an act of the Board of Directors in their official capacity, but of the individual Directors, participating in it, who personally meet such obligations as it imposes and who have controlled the policy of the R. R., pursued, since July 1871.

CHAS. B. HAZELTINE,
SAM'L OTIS,
PHILO HERSEY,
WM. H. BURRILL,
JOHN G. BROOKS,
EDWARD JOHNSON,
WM. M. WOODS,
DANIEL FAUSCE,
JOSIAH MITCHELL.

Dated, Belfast, Feb. 27th, 1882.

The Opinion.

I am asked my opinion as to the respective rights of the preferred and non-preferred stockholders in the Belfast and Moosehead Lake Railroad to the earnings of the road.

The charter authorized the company to issue both classes of stock, and I understand the by laws were adopted by the corporation before subscriptions to stock were obtained. The 18th by-law provides that:

"Dividends on the preferred stock shall first be made semi-annually from the net earnings of said road, not exceeding six per centum per annum, after which dividend, if there shall remain a surplus, a dividend shall be made upon the non-preferred stock up to a like per cent. per annum, and should a surplus then remain of the net earnings after both of said dividends in any one year, the same shall be divided pro rata on all the stock."

As the subscriptions for stock were made under the charter and this by-law the by-law would be regarded as entering into the contract. Davis vs. Proprietors, 8 Met. 321.

Article 20 of the original by-laws provides for an alteration of the by-laws at certain meetings. This of course must be regarded as assented to by the subscribers to stock, but I do not think an amendment could have the effect to change the substantial rights of the stockholders, as they existed at the time of subscription. Preferred stock, as we call it, or preference shares, as it is called in England, by the name itself indicates its character. It is a stock entitled to benefits in preference to other stock, and it may be in exclusion of it;—while it is stock, and to creditors of the corporation holds no higher rights than common stock, as the creditors are to be paid if it takes the whole income, or the whole property, as between the stockholders it largely partakes of the character of a preferred loan to the corporation, the principal never to be repaid, but the stipulated interest or dividend to be absolutely paid out of a designated fund,—ordinary earnings,—if sufficient from year to year to do it.

Preferred stock is only a form of mortgage, says Judge Redfield in his work on Railways, § 237. See Green's Brice's Ultra Vires, 21 ed. p. 164, note. Union Pacific R. R. vs. United States, 99, U. S. 423.

Such stock can only be issued when the charter or some statute gives the authority, or all the stockholders assent. In this case the authority is in the charter, and it was exercised before any subscriptions for stock were made, so that the assent of all the stockholders has been given to this issue. Green's Brice's Ultra Vires p. 164, note.

The 18th by-law expressly provides for a preference in dividends to the preferred stock. As between the stockholders all the burden of debts of the corporation should fall on the non preferred stock.

The fair construction of the by-law requires the net earnings to go first to pay a dividend of 6 per cent to the preferred stock, if the net earnings are sufficient to do so. The by-law is to have a reasonable application, having reference to the business and common experience in such matters. Under similar provisions the courts have uniformly held that as between the stockholders, the net earnings are to be applied first to the payment in full from year to year of the agreed dividends on the preferred stock whether the non-preferred stock receives anything or not. Bailey vs. Railroad, 17 Wal. 96 (U. S. Supreme Court.) Bates vs. A. & K. Railroad, 49 Me. 491.

This right of preferred stockholders will be enforced by the courts, and such stockholders may have an injunction from the court to restrain the payment of dividends to a non-preferred stockholder, or otherwise to divert the income of the corporation to the detriment of the preferred stock. Redfield on Railways, § 211. Henry vs. Great Northern Railway, 30. Law Times, pp. 10, 141. Gifford vs. N. Jersey Railway, 2 Stockton's Ch. Rep. 171. Green's Brice's Ultra Vires p. 164, note, p. 173. 678. Williston vs. Mich. Southern & N. Ind. R. R. 13 Allen. 405. Samuel vs. Holladay (per Miller J. N. S. Supreme Court) Am. Cor. Cases, Vol. 1, p. 151.

Dividends to ordinary or non-preferred stockholders are declared at the discretion of the Directors, and of such portion of earnings as they deem desirable, and if they act in good faith the stockholders

cannot have a decree for a dividend from the court, as preferred stockholders may. To the non-preferred stockholders the Directors act as trustees, and are required to exercise their judgment to manage the property, and make provision for debts and liabilities and repairs of corporate property, and from time to time declare such dividends from profits as in their judgment may be judicious. From the earnings they should pay current expenses of the business, matured debts, interest on unmatured debts, and make provision, if practicable, by sinking fund or otherwise for liabilities to mature, as they deem prudent, unless otherwise legally directed by the stockholders. These duties of the Directors are recognized in the text books and many decisions. Butts vs. Wood, 38, Barb. 181. B. Knapp vs. Davis, 19, Me. 455. Bedford R. R. vs. Bowser, 48 Pa. St. 29. Brown vs. R. R. 4 Eng. L. & E. 118. Jackson vs. Newark R. R. 2 Vron 277. Green's Brice's Ultra Vires, p. 201 and note a. R 45-46 on Railways §. 22 & note & S. 212.

Creditors are entitled to all the earnings, if necessary, to pay matured obligations, and it is certainly competent and proper for the Directors to apply the income to such payment without waiting for creditors to compel it.

If the 18th by-law was susceptible of any other construction, it would be unreasonable and in violation of the rights of creditors, and would not be upheld by the courts. It is therefore to be construed, as it may be consistently with its language, as protecting the preferred stockholders, and after that vesting in the Directors their usual legal authority to use the surplus in good faith to provide for maturing obligations, to the exclusion, in whole or in part as the case may result, of dividends to the ordinary stockholders. This view is fully sustained by Chief Justice Shaw. Barnard vs. Vermont and Mass. R. R. 7 Allen, 520.

That the stockholders so understood the by-law is made certain by the vote of January 15th, 1870, by which they authorized a second mortgage to secure bonds with coupons, drawing six per cent. absolutely to the preferred stockholders, while the bonds to non-preferred stockholders draw such interest as they could obtain under this by-law.

My construction therefore of the 18th by-law, and the contract thereby created is that the corporation guaranteed to the preferred stockholder six per cent. on his stock, if the net earnings are sufficient to pay it. That as to the surplus, if any remaining, the Directors were not obliged to divide it all, if in their judgment it was prudent to retain a portion to provide for maturing obligations, and that as to such surplus, they had the right, if they saw fit, without the amendment to the by-law, to create a sinking fund to pay the maturing city note. The dividend is to be made "from the net earnings," and the surplus, after paying preferred stock dividends, means the surplus which the Directors, in the exercise of their fair judgment, think can be divided to the general stockholders, without detriment to the credit of the corporation or its legal liability and true interest to provide for its maturing obligations. The opposite view would lead to a distribution of all the income from year to year, and when the city note shall mature, the corporation would have nothing with which to pay it, and might be sued and have its franchise sold on execution and thus destroy the whole property of both sets of stockholders. Such a course would be bad business management, would not be approved by the courts, and very possibly might make the Directors personally liable. Such a construction therefore, I apprehend, would not be adopted either by the court or business men, and must be unsound as it leads to such ruinous results.

The important question remains, What are "net earnings"?

The phrase has no absolute, defined legal meaning. It is sometimes used in one sense and at times in others. To correctly understand it in a given case, the circumstances under which it is used, the subject matter, the situation of the parties, and the property expected to make the earnings, must be considered.

In the Union Pacific R. R. vs. United States, 99 Supreme Court reports, the court was called upon to decide its meaning as used in the act of Congress granting aid to the Railroad which requires the road to pay to the United States upon its debt to them, a portion of its net earnings. A majority of the court say that they have to determine "the expenditures which are properly chargeable against the gross earnings in order to arrive at the net earnings, as this expression is to be understood within the meaning of the Act. As a general proposition net earnings are the excess of the gross earnings over the expenditures defrayed in producing them. It may often be difficult to draw a precise line between expenditures for construction and the ordinary expenses incident to operating and maintaining the road, and works of a railroad company.

"Theoretically, the expenses chargeable to earnings include the general expense of keeping up the organization of the company, and all expenses incurred in operating the works and keeping them in good condition and repair, whilst expenses chargeable to capital include those which are incurred in the original construction of the works, and in the subsequent enlargement and improvement thereof.

"With regard to the last mentioned class of expenditures, however, namely, those which are incurred in enlarging and improving the works, a difference of practice prevails among railroad companies. Some charge to construction account every item of expense, and every part and portion of every item which goes to make the road or any of its appurtenances or equipments better than they were before, whilst others charge to ordinary expense account and against earnings, whatever is taken for that purpose from the earnings, and is not raised upon bonds or issues of stock. The latter meth-

od is deemed the most conservative and beneficial for the company and operates as a restraint against injudicious dividends, and the accumulation of a heavy indebtedness."

"The question is one of policy which is usually left to the discretion of the Directors." "For making all ordinary improvements, as well as repairs, it is better for the stockholders and all those who are interested in the property of the enterprise that a portion of the earnings should be employed." pp. 420, 421. And while the court held in that case in construing the statute involved, that interest on the bonded debt should be charged to capital and not to current expenditures, they allowed as current expense a charge for building stations, shops, etc. In regard to the interest on bonded debt, the court says, p. 422. "Though payable out of earnings before any dividend can be made to stockholders, they cannot be deducted for the purpose of ascertaining the net earnings of the road as that term is to be understood in the sixth section of the Act."

"The bonded debt incurred for the purpose of construction and equipment is but another form of capital, analogous to preferred stock."

The court thus recognizes the fact that the term "net earnings" has different meanings according to the circumstances to which it is applied, and as to stockholders seeking dividends it has the same significance as net income,—that is, that portion of the earnings that remains proper to be divided among the stockholders after paying all expenses of operating, floating and matured debts, current interest, and even permanent improvements, which are charged to current expense account, and making provision for maturing debts, when prudent management so requires. In that case the United States were creditors and their right as such were to be determined. As to stockholders the court hold the rule would be different.

The true definition of "net earnings" as regards dividends to stockholders, is stated by the Supreme Court of the United States in St. John vs. Erie Railroad, 22 Wallace, 148. The court say: "The preferred dividends were to be paid out of the net earnings of the road. The lexical definition of net is, 'Clear of all charges and deductions.' (Webster.) 'That which remains after the deduction of all charges or all outlay, as net profit.' (Worcester.) The popular acceptance of the term is the same."

To the same effect is St. John vs. Erie R. R. 10 Blatch. 271. In that case the court say: "When all liabilities are paid, either out of the gross receipts or out of the net earnings, the remainder is the profit of the stockholders to go towards dividends which in that way are paid out of the net earnings."

Unless the contract shows that terms are used in a technical sense, they are to be understood in the ordinary popular sense. This by-law was adopted by practical business men, who knew that if the road was extended to Moosehead Lake, as contemplated, a debt would undoubtedly be incurred, or at least might be. They also knew that under the terms of the subscription work should not be commenced till enough was subscribed to build the road from Belfast to a junction with the Maine Central, that no provision was made for rolling stock, and that a debt would necessarily be incurred for such rolling stock, which naturally should be paid from earnings. With this knowledge by the stockholders it is absurd to suppose that they used the term "net earnings" as applied to dividends in a sense which would exclude payment of such floating debts or the interest yearly accruing. That they used the term in the practical sense of net income, or net profit, is made even more manifest by the amendment to the 18th by-law adopted by the stockholders in which they define the term.

I hold that as between the two classes of stockholders, in matters of dividends, the amendment does not enlarge or restrict the scope and true interpretation of the original by-law.

1. The result is, in my opinion, that net earnings, under the 18th by-law, as applied to dividends, mean that portion of gross earnings which remain after paying interest on the debt, expense of maintaining organization, expense of operating and repairs, if any, matured debts, and such an amount retained for a sinking fund as may be necessary to pay the floating debt at its maturity, if this can be done consistently with the rights of the preferred stockholders.

2. That from the net earnings so ascertained the preferred stockholders are entitled to receive six per cent. per annum, if there is enough to pay it, before the common stockholder receives anything.

3. That under the original by-law the Directors are authorized, and it is their duty, to create and maintain a sinking fund sufficient to pay the city note at maturity, if this can be done, after paying six per cent. to the preferred stock, unless the preferred stockholders consent to increase the sinking fund by accepting less than six per cent.

4. That as between the stockholders, no portion of the debt is to be assessed on or borne by the preferred stock, but on the contrary, the preferred stockholders have the right to require that no dividend shall be paid to the non-preferred stockholders and that the sinking fund shall not be divided or diverted, if by so doing it will endanger the security of the preferred stockholders to their six per cent. dividend.

5. Of course if creditors of the corporation require for their payment the whole or a large part of the earnings, or even the franchise and property of the Railroad they would be entitled to it, although the effect might be to depreciate or destroy the value of both classes of stock—but with this qualification, the preference secured to the preferred stock is to continue perpetually.

S. C. STROUT.