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A true copy.

McCARTER & ENGLISH,
Solicitors of Complainant.

BILL OF COMPLAINT.

Filed May 29, 1923.

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In Chancery of New Jersey

*To the Honorable Edwin Robert Walker, Chancellor of
the State of New Jersey:*

The complainant, Philip M. Grausman, of the City,
County and State of New York, respectfully shows unto
your Honor:

1. Complainant is a stockholder in Porto Rican-American Tobacco Company, a corporation organized and existing under the laws of the State of New Jersey, and brings this Bill on behalf of himself and such of the other stockholders of the said corporation as will come in and contribute to the cost of this suit.

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2. Defendant, Porto Rican-American Tobacco Company was incorporated under the laws of the State of New Jersey on the 22nd day of September, 1899. Its objects and powers are stated in its Certificate of Incorporation, a true copy of which, marked Schedule "A," is hereunto annexed and made a part hereof.

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3. The authorized capital stock of the defendant corporation is \$10,000,000., having been increased from \$5,000,000. on March 10, 1921. There was outstanding on December 31, 1922, \$6,277,850. par \$100. all common stock, there being no preferred stock.

4. Complainant owns 325 shares of the said stock and has owned that amount since 1919, all of which stock stands in his name on the books of the defendant corporation.

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5. The defendant corporation controls, through stock ownership, the following companies:

10 Porto Rican-American Tobacco Co. of Porto Rico, incorporated in Porto Rico, with \$10,000,000. authorized capital stock of which \$6,860,000. has been issued, all of which is owned by the defendant corporation. This subsidiary owns and operates all the properties in Porto Rico formerly owned by the defendant corporation, consisting of ten factories for the manufacture of cigars and cigarettes in Porto Rico.

20 New York-Tampa Cigar Co. incorporated in Delaware, with an authorized capital stock of 15,000 shares common of no par value and \$500,000. preferred of \$100. This subsidiary acquired the business and assets of M. Alvarez & Co. and the Industrial Co. of Porto Rico. All the common and the preferred stock of this company was issued to the defendant corporation, which owns over 60% of the common and all of the preferred stock. Its cigar manufacturing plants are located at Perth Amboy, New Jersey, and Tampa, Florida.

Porto Rican Leaf Tobacco Co. incorporated in New Jersey with \$500,000. capital stock, par \$100. This company grows the entire available supply of Porto Rican shade tobacco wrapper leaf. The defendant corporation owns 50% of the capital stock.

30 6. The defendant corporation is the most important factor in the Porto Rican tobacco industry and is one of the largest manufacturers of cigars in the United States. Since the establishment of its business in 1897 it has grown from a production of 3,000,000 cigars and little cigars and 500,000 cigarettes in 1899 to nearly 250,000,000 cigars and little cigars and nearly 500,000,000 cigarettes in 1920. The cigars are sold throughout the United States under well known brands. The cigarettes are sold almost exclusively in Porto Rico where the company does about 40 90% of the cigarette business of the Island.

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7. The defendant corporation, for the seventeen years from 1904 to 1920 inclusive, has paid dividends in cash, scrip and stock averaging over 20% per annum as follows: 1904, 8%; 1905, 31½%; 1906, 84%; 1907, 101½%; 1908, 5%; 1909, 9%; 1910, 14%; 1911 and 1912 16% each; 1913, 17%. In December, 1912, an extra dividend of 20% was paid in scrip and in March, June, September and December, 1913 and 1914, and in March, 1915, scrip distributions of 5% each were made, all of said scrip dividends being redeemable in cash or stock at par, at the company's option. In June, 1915, cash dividends were resumed by payment of 4%, which rate was regularly paid to June, 1917, inclusive; in September and December, 1917, scrip dividends of 4% each were paid; in June, September and December, 1918, March and June, 1919, March, June, September and December, 1920, and March, 1921, dividends of 3% each were paid in three-year scrip; Stock dividends have been paid as follows: 10% on December 7, 1916, and 4% on March 7, 1918.

8. The policy of the defendant corporation during the past ten years has been to conserve its cash resources by declaring scrip dividends, redeemable in three years thereafter in cash or stock at the option of the company, and the company has generally exercised that option by redeeming in stock, thereby greatly adding to its resources and providing the additional working capital required for the expansion of its business. From time to time the capital stock has been issued to redeem an equal amount of such dividend scrip, including the scrip paid in 1920. Of its present outstanding stock of \$6,277,850. over 45%, or \$2,894,420., represents the issue at par of stock in exchange for scrip, and on December 31, 1922, there was outstanding scrip redeemable in capital stock of \$36,423. and scrip of March, 1921, of \$149,026.50.

9. The only funded debt of the defendant corporation on December 31, 1922, was \$2,385,500. ten year 8% sinking

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fund gold bonds of a total authorized of \$3,000,000 dated May 15, 1921, which was issued to fund outstanding floating debt and to increase working capital, the company having sustained a very large loss during the preceding twelve months through strikes and the great deflation in merchandise values of that period, as hereinafter more
 10 fully set forth. These bonds are subject to call as a whole, but not in part, on any interest date on 30 days' notice at 107½ on or before May 15, 1926, and at 105 thereafter and as a sinking fund the company agreed to set aside in each semi-annual period a sum sufficient to purchase \$150,000. face value of bonds if obtainable at prices not exceeding 105 and interest, all bonds so purchased to be cancelled. On December 31, 1922, there was
 20 outstanding \$2,385,500. of said bonds, which at the time of the commencement of this action had been reduced to about \$2,250,000., all of which is substantially in excess of the sinking fund provisions.

10. For 1921 the defendant corporation showed a loss for the first time in its existence, when through labor troubles all its factories were closed for nine months and it was obliged to radically write down all inventories at the close of the year. This unusual loss amounted to \$2,392,363. and necessitated the issuance of the aforesaid \$3,000,000. ten year bonds, for the purpose of funding the
 30 resulting floating indebtedness. On March 3, 1922, L. Toro, as President, sent a letter to the stockholders of the company explaining this loss, as follows:

“March 3rd, 1922.

To the stockholders of Porto Rican American Tobacco Company:

The year ending December 31, 1921, has been most harrowing and disappointing, and the first year in the existence of your company in which a loss has been shown.

Your company for a number of years past has
 40 had more or less labor troubles. It has not been

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able to work continuously for any year during the last five years.

The unjust demands of labor culminated in December, 1920, when it became impossible to continue operating under the conditions that existed, and your Board of Directors then decided that drastic action was necessary to protect your interests and insure the future welfare of the brands of your company, and accordingly, all your cigar factories were closed in January, 1921. Since that date and up to September, 1921, a period of nine months, a continuous struggle was waged with labor, which was contending for the closed shop, but finally by the end of September your company succeeded in gaining its point and started manufacturing again on the open shop basis. It is gratifying to be able to advise that very little labor trouble has occurred since.

10

Wages were not reduced until December 1, 1921, for in order to win the strike, it was necessary to maintain the same standard of wages existing during the war period; hence, the few months' operations during the year 1921 were based on the same labor cost as during the war period.

20

Unfortunately for your company, labor conditions prevented the working of a good deal of the 1920 crop of tobacco, which was the most expensive crop ever harvested in Porto Rico, and this fact made it necessary to make readjustments of and write down all inventories at the end of the year. Your company is now going through the readjustment period, just as other companies engaged in a like business are doing.

30

The policy of retrenchment has been established in every department and your company hopes to be able to effect still further economies.

Very respectfully,

L. Toro,
President."

11. The business depression which continued through the first half of 1922 resulted in substantial losses from operations during that period, but the company's business

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during the latter part of that year showed a satisfactory result, so that the net loss for the year was only \$390,-238.41. During the current year the result of operations has been very satisfactory and shows a continuing expansion in business and increase in profits over the latter part of 1922; labor conditions have been satisfactory and
10 the Porto Rico tobacco crop is reported as unusually good, as a result of which the company is making rapid progress in returning to its former highly profitable basis of operations.

12. As more fully appears by its consolidated balance sheet dated December 31, 1922, hereto annexed and made a part hereof as Schedule "B," the defendant corporation at that time had current assets consisting of leaf tobacco, manufactured stock, operating supplies, etc., at \$4,057,866., accounts and bills receivable \$2,018,591. and
20 cash \$637,804. a total of \$6,734,261. and at the same time its liabilities for current accounts and bills payable aggregated \$1,038,880. which is approximately \$6.50 in current assets to every dollar of liability and in addition it has had cash available to voluntarily purchase and cancel its 8% ten year gold bonds in substantial excess of the sinking fund provisions for redeeming same.

13. In August, 1912, the stockholders of the defendant corporation authorized a plan whereby 10% of its excess profits over those of 1910 are distributed among the
30 President, Vice-Presidents and Treasurer of said company, and the individuals holding said offices are the beneficiaries of said bonus provisions.

14. The Board of Directors of the defendant corporation is composed of Luis Toro, John Frese, F. L. Kenny, A. H. Noble, H. Catlin, H. D. Newton, A. H. Burroughs, H. L. Brown and N. Pasarell, and of these the said Luis Toro is President, John Frese is First Vice-President, F. L. Kenny is Second Vice-President, A. H. Noble is

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Treasurer and H. Catlin is Secretary and Assistant Treasurer of the defendant corporation.

15. Said Luis Toro, the President, A. H. Burroughs, a Director, and H. Catlin, Secretary and Assistant Treasurer of the defendant corporation, who are stockholders in said company, have solicited and received and hold proxies from stockholders of the said company, authorizing them to vote stock in favor of a certain proposition hereinafter fully set forth at a special meeting of the stockholders of the said company to be held at Jersey City, New Jersey, on the thirty-first day of May, 1923. 10

16. Tobacco Products Corporation, a corporation existing under the laws of the State of Virginia, with its principal office in the City, County and State of New York, where it has been authorized to do business, is a corporation likewise engaged in the manufacture and distribution of tobacco, cigarettes, etc. Among various subsidiary companies, which it controls, through stock ownership, or in which it has a substantial stockholding interest, are the following: Falk Tobacco Co., Khedival Co., M. Melachrino & Co. Inc., The Melachrino Tobacco Trading Co. Inc., Nestor Gianacis Co., Prudential Tobacco Co. Inc., Robert Harris & Bros. Inc., Schinasi Bros., Surbrug Co., Stephano Bros. Inc., Tobacco Products Export Corporation and John J. Bagley & Co. It also controls, through ownership of over 87% of Class A Common and Founders' shares the United Retail Stores Corporation which in turn controls the United Cigar Stores Co. of America, which is the principal customer in the United States for the cigars manufactured by the subsidiaries of the defendant corporation. 20 30

17. On March 13, 1923, the Board of Directors of the defendant corporation adopted and passed a resolution to the effect that it was advisable and for the best interests of the said corporation to so amend its Certificate of Incorporation with respect to its capital stock provi- 40

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sions that there be authorized a total issue of preferred stock to consist of 150,000 shares of the par value of \$100. per share, and 150,000 shares of stock without nominal or par value, which the Board of Directors might issue as stock dividends, or which they might sell in whole or in part as from time to time might be fixed by the said Board, and other provisions, as is more fully set forth in a copy of the Resolution of the said Directors sent out by said defendant corporation under date of March 22, 1923, a copy of which is hereto annexed and made a part hereof, marked Schedule "C".

18. The purpose of the said proposed amendment of Certificate of Incorporation and the intent of the said defendant corporation with respect to the distribution of the capital stock to be then authorized was to convert the present stock of the defendant corporation, all of which is common stock, into a full voting 7% cumulative preferred stock of the same par value of the present stock, namely: \$100. per share, which would be entitled to participate with the common stock after dividends of \$7. per share had been paid on each class of stock. Of the non-voting common stock without nominal or par value to be created, the defendant corporation had declared that Tobacco Products Corporation would buy at \$25. per share as many as 64,566 shares, being equal to the number of shares of the existing stock now outstanding plus the number of shares necessary to redeem the outstanding dividend warranties as is more fully set forth in a letter from the defendant corporation dated March 22, 1923, a copy of which is hereto annexed and made a part hereof as Schedule "D".

19. In and by the resolution of March 13, 1923, the Board of Directors of the defendant corporation called a special meeting of the stockholders of the said company to be held at Jersey City, N. J., on the 11th day of April, 1923, for the purpose of taking action on the said resolution of March 13, 1923. After the notice of

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said meeting had been sent out and prior to the holding thereof, complainant filed his Bill in this Honorable Court praying that the holding of said meeting and taking of action on said resolution be restrained, and thereupon such proceedings were had that an Order was made requiring the defendant corporation to show cause why the adoption of the said resolution of March 13, 1923, should not be restrained and meanwhile staying all proceedings thereon. 10

20. Thereafter the defendant corporation, recognizing the invalidity of the plan proposed in the said resolution of March 13, 1923, abandoned the same. An Order was entered upon the consent of attorneys for both parties dismissing complainant's bill.

21. On May 3, 1923, the Board of Directors of the defendant corporation adopted and passed a resolution to the effect that it was advisable and for the best interests of the company to so amend the Certificate of Incorporation with respect to its capital stock provisions, and that in addition to the present authorized capital stock of 100,000 shares of the par value of \$100. per share, all of one class (referred to as Class A common stock) there be authorized an issue of 100,000 shares of Class B common stock, without nominal or par value, and without voting power, which the Board of Directors might issue in their discretion, in whole or in part, to the holders of Class A common stock as a stock dividend, or offer to them the right to subscribe for same or otherwise dispose of in accordance with law, as is more fully set forth in a copy of said resolution sent out by said defendant corporation under date of May 10, 1923, copy of which is hereto annexed and made a part hereof as Schedule "E". The purpose of said proposed amendment to the Certificate of Incorporation is to offer said Class B common stock at \$25. per share, this offer to be first made to the holders of the present common stock and after the payment of cumulative dividends 7% 20 30 40

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on Class A common stock, to pay dividends equal to \$7.00 per share on Class B common stock for the fiscal year, as more fully appears by a reference to said resolution and also to the letter of L. Toro, President of the defendant corporation, to the stockholders, dated May 10, 1923, hereto annexed and made a part hereof as Schedule "F".

10 22. In and by said resolution of May 3, 1923, a special meeting of the stockholders is called to be held on May 31, 1923, at eleven o'clock in the forenoon at the office of the company in Jersey City, for the purpose of considering and taking action thereon, and complainant shows that a sufficient majority of the capital stock of the defendant corporation is controlled by the directors thereof and those closely associated with them, to approve at the stockholders' meeting the resolution of the Board of Directors to amend the capital stock provisions

20 of the company as stated in said notice.

23. Complainant alleges that the present proposed scheme to amend the capital stock provisions of the Certificate of Incorporation is contrary to law and to the power of said corporation and is detrimental to the rights of its stockholders; that a transaction of this kind, even with the consent of a majority of the stockholders would be contrary to equity and good conscience, and would be an unlawful use and abuse of corporate property and

30 of the stockholders' vested rights; and is *ultra vires* and beyond the power of the defendant corporation as against the objection of any stockholder; that he, as a stockholder, objects to the consummation of this deal and charges that the same is *ultra vires* the defendant corporation and in fraud of his rights as such stockholder; that the proposed amendment to the charter of the defendant corporation changes the fundamental arrangement and plan of the corporation and violates the contractual rights of stockholders, in that under the charter

40 of said corporation and the laws existing at the time of

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its incorporation, there were no provisions authorizing an amendment of the charter to permit the issuance of stock without nominal or par value; that the proposed amendment is in effect confiscatory of the stockholders' rights and interests in the corporation, and creates a situation where the present stockholders' rights in the existing common stock are limited as to dividends and also as to distribution of corporate assets in the event of dissolution; that the present proposed amendment and the present proposed scheme further violates the rights of the stockholders and is contrary to the Charter of the defendant corporation and the laws of the State of New Jersey, in that it will authorize or permit the issuance of the proposed Class B Common Stock with dividend rights of 28% for each \$100. paid for the said Class B Common Stock after paying 7% on the present common stock of \$100. par value, and as to any additional distribution of dividends there will be 4% paid on each \$100. invested in the proposed Class B Common Stock to each 1% paid on the existing common stock.

24. Complainant further alleges that the present proposed plan is in effect a change of the existing common stock into 7% preferred stock which was the effort proposed by the resolution of the Board of Directors of March 13, 1923, which was subsequently abandoned, after attack by this complainant, in that the present proposed plan creates a new class of common stock and limits the dividends on the present common stock to 7%, such as is ordinarily the case in preferred stocks, and provides that after the payment of \$7.00 a share, which is in effect 28% on the proposed Class B common stock, the said present common stock shall share equally in dividends with the proposed Class B common stock, which was exactly the same plan as was proposed in the resolution of March 13, 1923, except that in said resolution it was frankly stated that the present common stock was to be changed into preferred stock. Complainant charges

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that the present proposed plan is a fraud on the statute and an effort by subterfuge and evasion to create a situation which is illegal and void, and an absolute violation of the contractual rights of the stockholders as fixed by the statute and the charter of the company, and said defendant corporation, having been foiled by the previous Bill of Complaint of this complainant from carrying out the plan proposed in the resolution of March 13, 1923, is now endeavoring, under a different guise and in a different manner, to obtain the same illegal result, to the detriment of the present stockholders, including complainant.

25. The complainant also alleges that prior to its labor disturbances and closing of factories due to strikes in 1921, the capital stock of the defendant corporation sold at over \$150. per share, but as a result of the losses of 1921, the market price of the stock declined to under \$50. a share. Following the publication of its annual report as of December 31, 1922, the market price of the stock advanced to \$92. a share on March 15, 1923, but since the publication of these proposed plans of its directors, the price has declined to \$78. per share, at which price it sold on May 22, 1923, on the New York Stock Exchange.

26. Complainant charges that the present proposed plan is in furtherance of the scheme which was more boldly set forth in the plan proposed in the resolution of March 13, 1923, in that it enables a group which controls the defendant corporation, some of whom are also dominant factors in the control of Tobacco Products Corporation and affiliated companies to secure a large amount of the proposed Class B common stock at a price which will enable them to procure substantially all the benefit of the earnings of the corporation by limiting the dividend rate on the present outstanding common stock, and providing for the payment of dividends which, as already pointed out, would be on the basis of 4% per \$100.

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invested for Class B common stock and 1% for each \$100. invested in the present common stock. In the letter of Luis Toro, President, to the stockholders, dated May 10, 1923, (Schedule "F") it is stated that the entire surplus of the company has been consumed and that it is of great importance that necessary working capital be provided for which purpose the company seeks to sell an additional amount of stock. A reference to the annual report for the year ending December 31, 1922 (Schedule "B") shows cash of over \$637,000 and accounts and bills receivable of over \$2,000,000. leaf tobacco and manufactured stock and supplies of over \$4,000,000. with accounts payable of only a little over \$1,000,000. Said report shows a surplus of \$8,803.57 which, however, is determined by the correctness of the reserve for depreciation stated in said report at over \$700,000. and complainant charges that the statement in the said letter of May 10, 1923 (Schedule "F") that the entire surplus has been consumed, is misleading and is for the purpose of frightening the present stockholders into consenting to the present proposed plan on the ground that their investment will be impaired unless additional capital in accordance with the present scheme proposed is brought into the company. It is significant that the President of the defendant company on February 21, 1923, in a letter to stockholders, a copy of which is annexed hereto as Schedule "G", stated that the company had every indication of bigger and better profits for the year 1923, and that profits from operations during the last quarter of 1922 before depreciation had been about \$150,000. Furthermore, the corporation has unissued stock already authorized of approximately \$3,700,000 as appears from Schedule "B", the balance sheet of the corporation, on December 31, 1922.

27. Complainant further alleges that the proposed amendment and scheme contemplated by the directors of the said defendant corporation, either among themselves,

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and other stockholders thereof, or in connection with other parties, will result in serious and irreparable injury to the said defendant corporation and to the interests of stockholders other than those who are acting solely in the interests of themselves and their associates, as hereinabove charged, and in a manner detrimental and destructive to the interests of the defendant corporation and of the rights of stockholders other than themselves and those associated with them; that the said proposed scheme has been unlawfully, wrongfully, fraudulently, oppressively and inequitably conceived for the purpose of diverting the control of the earnings of the defendant corporation and the acquisition of valuable stock rights from its present stockholders at a time when said stockholders have sustained all the burdens resulting from the operations of the defendant corporation, first, during the years when dividends were paid in scrip, and subsequently converted into stock, as hereinabove set forth, during the period when the company's expansion required the conservation of its earnings, and more recently after the said stockholders have sustained the losses during the period of long and costly strikes and radical inventory deflations, and when at the present time the business of the defendant corporation is making rapid progress and its earnings and income are being steadily restored to its former highly profitable basis.

28. The complainant further alleges that the holders of a large majority of the stock of the said defendant corporation, including its directors and those associated with them, have authorized or are about to authorize said Toro, Burroughs and Catlin, as proxies, to vote at said special stockholders' meeting in support of the said present proposed plan for the purpose of bringing it into effect, in violation of the rights of the complainant and other stockholders dissenting therefrom, unless restrained by this Honorable Court; that he has declined to give a proxy, as requested, for the said special meeting, or to assent to any of the proposed acts to be done by the

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proxies, or to the proposition submitted in the notices hereinabove referred to, and that he does now protest against such acts of the said proxies and against any ratification or confirmation by the stockholders of the acts of the directors of the said defendant corporation and attempted adoption of the proposed plan.

29. The complainant further alleges that the directors 10
of the above-named corporation have wrongfully and unlawfully conspired together to do the things hereinabove mentioned at the proposed stockholders' meeting to be held at Jersey City, N. J., on the 31st day of May, 1923 as alleged, or at any adjourned time thereafter, and that they have endeavored to secure the control of a sufficient amount of capital stock of the defendant corporation now outstanding either by person or by proxy to have the same represented at said meeting and voted in favor of the plan above set forth, unless restrained by this Hon- 20
orable Court.

30. Complainant shows that it would be futile to request the Board of Directors of the defendant corporation to commence this suit or to seek this relief, inasmuch as said Board of Directors have passed the resolution and called the meeting for adoption of the amendment to the Charter to which this complainant objects.

Complainant is without adequate remedy in the courts of law and therefore prays: 30

1. That the defendant, Porto Rican-American Tobacco Company, may answer this Bill of Complaint and each statement therein made.

2. That defendant, Porto Rican-American Tobacco Company, its directors, officers, agents, tellers and inspectors, may be enjoined and restrained from submitting to the stockholders of the defendant corporation at meeting of the said stockholders to be held on the thirty-first day of May, 1923, or at any adjournment thereof, or at any other meeting, the proposition to take action upon 40

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the resolution of the Board of Directors of the said defendant corporation adopted and passed May 3, 1923, as fully set forth in Schedule "C" annexed to this Bill, and that they be enjoined and restrained from passing any resolution or receiving or counting any votes in favor of any resolution designed to carry into effect or accomplish any such proposition and from taking any steps or means whatsoever toward effecting or perfecting the accomplishment thereof.

3. That the complainant may have such other and further relief as to the Court may seem just.

4. That a Writ of Subpoena may issue, commanding said defendant to answer this Bill of Complaint, and to abide by such decree as this Court may make in the premises.

McCARTER & ENGLISH,
*Solicitors for and of Counsel
with Complainant.*

STATE OF NEW YORK }
COUNTY OF NEW YORK } ss.

PHILIP M. GRAUSMAN, being duly sworn according to law, upon his oath deposes and says:

I am the complainant in the foregoing Bill of Complaint named; I have read the Bill and the matters and things therein contained are true.

I am the owner and holder of record of 325 shares of the common stock of Porto Rican-American Tobacco Company, of the par value of \$100. per share, and have owned said stock ever since 1919.

The defendant corporation was incorporated under the laws of the State of New Jersey by Certificate filed on September 22nd, 1899 as stated in paragraph 2 of the Bill, and a true copy of the Certificate of Incorporation is annexed as Schedule "A".

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It is true, as stated in the Bill, that the defendant corporation controls, through stock ownership, the various companies set forth in paragraph 5 of the Bill.

The matters of fact stated in paragraphs 6 and 7 of the Bill are matters of public record set forth in published reports of the defendant corporation, and in the financial compilations, such as Moody's Manual and Standard Statistics. 10

It is true, as stated in the Bill, paragraph 8, that dividends have been declared as therein set forth, and I have received my share of such dividends since I have been the owner of stock.

I am familiar with the fact of the outstanding bond issue, as set forth in paragraph 9, and I am informed on the authority of a statement of the Secretary of the company that it has now been reduced to \$2,250,000.

I am familiar generally with the fact that the defendant company went through a period of business depression, as specified in the letter of the President to the stockholders dated March 3, 1922, as set forth in paragraph 10 of the Bill, and that at the present time the labor difficulties which were there mentioned have been settled and that the company is once more successful and making money. 20

I am familiar with statements of fact set forth in paragraphs 11, 13, 14 and 16 from investigations made at my request by William K. Dupre, Jr., a member of the New York Bar. These same facts appear in the financial compilations above referred to. 30

Schedule "B" referred to in paragraph 12 is a copy of the annual report of the defendant corporation for the year ending December 31, 1922.

Paragraph 17 is based on statements contained in Schedule "C" paragraph 18 is based on statements contained in Schedule "D" both of which Schedules were sent out to the stockholders by the defendant corporation.

It is true, as stated in the Bill, paragraphs 19 and 20, that following the resolution of March 13, 1923 I filed 40

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my Bill in this court and obtained a restraining order against the holding of the meeting called to be held pursuant to the resolution of March 13, 1923.

10 It is true, as stated in the Bill, paragraph 15, that the officers of the company are seeking proxies for a special meeting to be held on May 31st, 1923. I received through the mail a copy of the resolution and the letter of the President referred to in the Bill as Schedule "E" and Schedule "F" respectively, and also form of proxy which proxy I have declined to sign.

20 The plan as set forth in the resolution of May 3, 1923 (Schedule "E") seeks to create a new issue of stock without par value and seeks to make the existing common stock in effect a seven per cent. preferred stock. The defendant corporation in this matter is seeking in a different way to do what it was prevented from doing under its resolution of March 13, 1923. In that resolution it came out frankly with the proposition to change the existing common stock into seven per cent. preferred stock and then to pay dividends equally on the preferred stock and the no par value stock after \$7.00 a share had been paid on the no par value stock which was to be sold at \$25. and 7% had been paid on the preferred stock. The present scheme is in effect the same thing, except there is now no proposition to change the existing common stock into preferred stock, but instead, it is proposed to limit the dividends on the existing common stock to 7% until such time as the no par value stock has received dividends of \$7.00 per share, which, on a valuation of \$25. per share, would make a total of \$28. paid on the no par value stock to \$7.00 paid on \$100. par value stock, and after those payments had been made to have the two stocks share equally in dividends. The similarity of the present scheme over that of the scheme proposed in the resolution of March 13, 1923 is apparent, the only difference being in that there is no proposed exchange of common stock into preferred stock but the present common stock which

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is to remain is in effect made 7% preferred stock on the same basis as the preferred stock would have been under the resolution of March 13, 1923 had that been allowed to be passed and adopted. The plan to sell the proposed no par value stock for \$25. a share and to pay dividends thereon at the rate of \$7.00 per share, in effect, requires the payment of dividends at the ratio of one to four on the no par value stock as opposed to the existing common stock before there is any equality of dividends on the two stocks as proposed in the said resolution, the effect of which, as appears from the resolution, Schedule "E" would be most inequitable and unfair to the present existing common stockholders. I have, therefore, declined to sign the proxy to vote at the proposed special meeting of stockholders and have not returned the proxy to the company. 10

PHILIP M. GRAUSMAN. 20

Sworn to and subscribed before me
this 26th day of May, 1923.

(SEAL)

ANNA T. CONWAY,

Notary Public, Kings County,

Kings County Clerk's No. 27 etc.

County Clerk's Certificate attached. 30

STATE OF NEW YORK }
COUNTY OF NEW YORK } ss.

WILLIAM K. DUPRE, JR., being duly sworn according to law, upon his oath deposes and says:

I am a member of the New York Bar.

I have read the Bill of Complaint and am familiar with the contents thereof.

On behalf of the complainant, Philip M. Grausman, I made investigations with respect to the financial condition of the defendant corporation. 40

Bill of Complaint—(Grausman).

The matters of fact set forth in paragraphs 5, 6 and 7 of the Bill of Complaint were obtained by me as a result of investigations which I made from published reports of the defendant corporation, financial compilations such as Moody's Manual and Standard Statistics and from the files of the National City Bank.

- 10 I also had a conversation with Mr. H. Catlin, Secretary of the defendant corporation, at his office 185 Madison Avenue, New York City, on March 30, 1923. I told him that I called on behalf of the complainant, to obtain information as to what was to be done at the meeting of the stockholders called to be held on April 11th, 1923, and he furnished me with copies of the Schedules annexed to the Bill as Schedules B, C and D. These schedules were set up in the form of printed notices which had been mailed to the stockholders. Mr. Catlin explained to me
- 20 the difficulties which the corporation had passed through during the past two years and he told me that the labor disputes had been completely settled and the factories were now being run as an open shop, to the complete satisfaction of Mr. Toro; that the workers were putting out more and better cigars than at anytime in the history of the concern; that during the last few months of 1922 business had improved and the company had gotten back to a money-making basis.

- 30 Referring to paragraph 9 of the Bill of Complaint, Mr. Catlin told me that the outstanding bonds had now been reduced to \$2,250,000.

The matters of fact set forth in paragraphs 10 and 11 of the Bill of Complaint were given me by Mr. Catlin.

The matters of fact set up in paragraphs 11, 13, 14 and 16 were obtained by me from the financial compilations above referred to.

- 40 The matters of fact set forth in paragraph 12 of the Bill were taken from the balance sheet of the defendant corporation which was given me by Mr. Catlin.

Bill of Complaint—Schedule A.

The matters of fact set forth in paragraph 25 of the Bill with respect to the price at which the stock is sold were obtained by me from Stock Exchange Reports furnished to me by Stock Brokers operating on the New York Stock Exchange.

The matters of fact set forth in the balance of the Bill were obtained from Schedules B, C, D, E and F, of which 10
B, C and D were received by me from Mr. Catlin, and E and F were received by the complainant direct from the defendant corporation.

WM. K. DUPRE, JR.

Sworn to and subscribed before me
this 28th day of May, 1923.

(SEAL)

ANNA T. CONWAY,

Notary Public, Kings County,

Kings County Clerk's No. 27 etc.

County Clerk's Certificate attached.

20

(10¢ I. R. Stamp Can.)

Schedule A.

CERTIFICATE OF ORGANIZATION
OF

PORTO RICAN-AMERICAN TOBACCO COMPANY

30

This is to certify that we, J. B. Cobb, Josiah Browne, John H. Wollard, W. T. Townes, Geo. M. Gales, J. T. Wilcox and M. S. Watts, do hereby associate ourselves into a corporation, under and by virtue of the provisions of an Act of the Legislature of the State of New Jersey, entitled "An Act Concerning Corporations, Revision of 1896", and the several supplements thereto, and acts amendatory thereof, for the purposes hereinafter men-

40

Bill of Complaint—Schedule A.

tioned, and to that end, we do by this our certificate, set forth:

1st. That the name which we have assumed to designate such corporation, and to be used in its business and dealings is

“PORTO RICAN-AMERICAN TOBACCO COMPANY”

10 2nd. The location of the principal office of such corporation in the State of New Jersey is at No. 765 Broad Street, in the City of Newark in the County of Essex. The name of the agent therein and in charge thereof, upon whom process against such corporation may be served, is C. A. Hopman.

20 3rd. The objects for which this corporation is formed are to cure leaf tobacco, and to buy, manufacture and sell tobacco in any and all its forms, and to erect, or otherwise acquire factories and buildings, establish, maintain and operate factories, warehouses, agencies and depots for the storing, preparation, cure and manufacture of tobacco, and for its sale and distribution, and to transport, or cause the same to be transported as an article of commerce, and to do any and all things incidental to the business of trading and manufacturing, aforesaid. This corporation shall also have power to conduct its business, or any portion of it, in all other states and territories; colonies and dependencies of the United States of America, and in Great Britain and Canada, and all 30 other foreign countries; to have one or more offices out of the State of New Jersey, and to hold, purchase, lease, mortgage and convey real and personal property out of the State of New Jersey, as well as in said State.

4th. The total amount of the authorized capital stock of the corporation is \$500,000, divided into 5,000 shares of the par value of \$100. each. The amount with which the corporation will commence business is \$1,000. divided into 10 shares of said stock of the par value of \$100. each.

Bill of Complaint—Schedule A.

5th. The names and post office addresses of the incorporators, and the number of shares subscribed for by each, the aggregate of such subscription being the amount of capital stock with which this Company will commence business, are as follows:

Names	Post Office Addresses	Shares	
J. B. Cobb,	765 Broad St., Newark, N. J.....	2	10
Josiah Browne,	765 Broad St., Newark, N. J.....	2	
John H. Wallard,	765 Broad St., Newark, N. J.....	2	
W. T. Townes,	765 Broad St., Newark, N. J.....	1	
Geo. M. Gales,	765 Broad St., Newark, N. J.....	1	
J. T. Wilcox,	765 Broad St., Newark, N. J.....	1	
M. S. Watts,	765 Broad St., Newark, N. J.....	1	

6th. The directors of the corporation shall be classified in respect to the time for which they will respectively hold office, and at the first election for Directors the several classes shall be elected as follows: Three shall be elected for one year, two shall be elected for two years, and two shall be elected for three years, and at the expiration of their respective terms, their successors shall be elected for three years, so that the term of each director, after those elected at the first election, shall be three years. If the number of directors shall be at any time changed, the Board of Directors shall have power to re-arrange the classification of the terms of the Directors. Meetings of the Board of Directors need not be held in the State of New Jersey, but may be held in such place or places, in any other State or States or elsewhere as the By-laws of the corporation may from time to time provide. The corporation may, through its Board of Directors, acquire and undertake the whole, or any part of, the business, property, assets, contracts, and liabilities of any person, firm or corporation, if the same are, in their judgment, useful in the business of this corporation.

The Board of Directors shall have the power, by vote of a majority of all the Directors, and without assent or vote of the stockholders, to make, alter, amend and rescind

Bill of Complaint—Schedule A.

the By-laws of this corporation, to fix the amount to be reserved as a working capital, and to fix what number of Directors shall constitute a quorum of the Board.

7th. The existence of this corporation shall commence on the date of the filing of this certificate in the office of the Secretary of State of New Jersey, and shall continue perpetually.

10

IN WITNESS WHEREOF, we have hereunto set our hands and seals the 22nd day of September, 1899.

J. B. Cobb	(L. s.)
Josiah Browne	(L. s.)
John H. Wollard	(L. s.)
W. T. Townes	(L. s.)
Geo. M. Gales	(L. s.)
J. T. Wilcox	(L. s.)
M. S. Watts	(L. s.)

20

Signed, sealed and delivered in the presence of
C. K. Faucette.

STATE OF NEW YORK	} ss.
CITY AND	
COUNTY OF NEW YORK	

30

BE IT REMEMBERED that on this 22nd day of September, 1899, before me, Charles K. Faucette, a Commissioner of the State of New Jersey, in New York, personally appeared J. B. Cobb, Josiah Browne, John H. Wollard, W. T. Townes, Geo. M. Gales, J. T. Wilcox and M. S. Watts, known to me to be the individuals described in, and who executed the foregoing certificate, and I first having made known to them the contents thereof, they did each acknowledge that they signed, sealed and delivered the same as their voluntary act and deed.

40

Bill of Complaint—Schedule A.

IN WITNESS WHEREOF I have hereunto set my hand, and affixed my official seal this 22nd day of September, A. D. 1899.

C. K. Faucette,
Commissioner of New Jersey
Resident in New York.

(SEAL)

10

(10¢ I. R. Stamp Can.)

ENDORSED:

Received in the Clerk's Office of the County of Essex, on the 22nd day of September, A. D. 1899, and recorded in Book 17 of Incorp. Buss Inc. for said County, Page 333 &c.

William O. Kuebler,
Clerk.

20

Filed Sep. 22, 1899

GEORGE WURTS,
Secretary of State."

PORTO RICAN-AMERICAN TOBACCO COMPANY,
a corporation organized and existing under and by virtue of the laws of the State of New Jersey, by its President and Secretary, DOES HEREBY CERTIFY:

I. That the principal office of the Company is at No. 15 Exchange Place, Jersey City, New Jersey, and that the agent therein in charge thereof, and upon whom process against the corporation may be served is CORPORATION TRUST COMPANY. 30

II. That the Board of Directors of said corporation at a meeting duly convened on the 23rd day of February, 1915, passed a resolution declaring that it was advisable to increase the Capital Stock of the Company to FIVE MILLION DOLLARS (\$5,000,000), and calling a meeting of the stockholders to take action thereon. 40

Bill of Complaint—Schedule A.

III. That a copy of said resolution of the Board of Directors is hereto appended.

IV. That thereafter on the 25th day of March, 1915, pursuant to such call of the Board of Directors, and upon notice given to each stockholder, as provided in the By-Laws, a special meeting of the stockholders of the Company was held, at which meeting more than two-thirds in interest of the stockholders having voting powers, to-wit, stockholders holding Seventeen Thousand and Nine (17,009) shares out of a total of Nineteen Thousand Nine Hundred and Ninety-four (19,994) shares issued, were present in person or represented by proxy, and that more than two-thirds in interest of the stockholders having voting powers, to-wit, stockholders holding Seventeen Thousand and Nine (17,009) shares out of a total of Nineteen Thousand Nine Hundred and Ninety-four (19,994) shares issued, voted in favor of such increase of stock.

V. That at said meeting of the stockholders, such increase was assented to in writing by more than two-thirds in interest of the stockholders having voting powers, to-wit, stockholders holding Seventeen Thousand and Nine (17,009) shares out of a total of Nineteen Thousand Nine Hundred and Ninety-four (19,994) shares issued, which said written assent is hereto appended.

VI. That Nineteen Thousand Nine Hundred and Ninety-four (19,994) shares of stock of said corporation are issued and outstanding.

IN WITNESS WHEREOF, the said PORTO RICAN-AMERICAN TOBACCO COMPANY has caused this certificate to be signed by its President and its Secretary, and its corporate seal to be hereto affixed, this the 25th day of March, 1915.

PORTO RICAN AMERICAN TOBACCO COMPANY

By L. Toro, President.

A. H. Noble, Secretary.

(COR. SEAL)

Bill of Complaint—Schedule A.

RESOLUTION OF THE BOARD OF DIRECTORS.

RESOLVED: That it is advisable that the capital stock of this Company be increased to Five Million Dollars (\$5,000,000) by adding Three Million Dollars (\$3,000,000) to the existing capital stock, such increase in stock to be divided into Thirty Thousand (30,000) shares of the par value of One Hundred Dollars (\$100) each, so that the total amount of stock of the Company shall be Five Million Dollars (\$5,000,000) divided into Fifty Thousand (50,000) shares of the par value of One Hundred Dollars (\$100) each, all of one and the same class; and that a Special Meeting of the Stockholders of the Company be, and the same is, hereby called to be held on the 25th day of March, 1915, at 10.30 o'clock A. M., at the principal office of the Company, at 15 Exchange Place, Jersey City, New Jersey, for the purpose of considering and taking action on such proposed increase of the capital stock of the Company, and that due notice of such meeting be given, and that upon obtaining the assent in writing and the approving vote of two-thirds in interest of the Stockholders of the Company, as required by law, the capital stock of the Company be increased as hereinabove provided, and that the certificate of incorporation be amended accordingly.

ASSENT OF STOCKHOLDERS.

We, the undersigned, subscribers and stockholders of PORTO RICAN AMERICAN TOBACCO COMPANY, a corporation organized and existing under and by virtue of the laws of the State of New Jersey, and owning and representing in the aggregate more than two-thirds in interest of the existing stock of said corporation, DO HEREBY CONSENT that the capital stock of PORTO RICAN AMERICAN TOBACCO COMPANY may be increased to FIVE MILLION DOLLARS (\$5,000,000) by adding THREE MILLION DOLLARS (\$3,000,000) to the

Bill of Complaint—Schedule A.

existing capital stock; such increase of THREE MILLION DOLLARS (\$3,000,000) to be in the stock of this Company and divided into Thirty Thousand (30,000) shares of the par value of One Hundred Dollars (\$100) each; so that the total amount of the capital stock after such increase shall be FIVE MILLION DOLLARS (\$5,000,000) divided into Fifty Thousand (50,000) shares of the par value of One Hundred Dollars (\$100) each.

WITNESS our hands, this the 25th day of March, 1915.

Names	No. of Shares
L. Toro	463
L. Toro Proxy	.16005
A. H. Noble	60
A. H. Burroughs	446
A. H. Burroughs Proxy	135

20

STATE OF NEW YORK }
COUNTY OF NEW YORK } ss.

BE IT REMEMBERED, that on this 25th day of March, 1915, before me, the subscriber, Henry L. Rupert, a Notary Public in and for the County of New York, in the State of New York, personally appeared A. H. NOBLE, Secretary of PORTO RICAN AMERICAN TOBACCO COMPANY, the corporation mentioned in and which executed the foregoing certificate, who being by me duly sworn on his oath says that he is such Secretary; that the seal affixed to the said certificate is the corporate seal of said corporation, the same being well known to him; that L. TORO is the President of said corporation and signed said certificate and affixed said seal thereto and delivered said certificate by authority of the Board of Directors of said Company and with the assent of more than two-thirds in interest of the stockholders of said corporation having voting powers, as and for his voluntary act and deed and the voluntary act and deed of said

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Bill of Complaint—Schedule A.

corporation, in presence of deponent, and thereupon subscribed his name thereto as witness.

AND he further says that the assent hereto appended is signed by more than two-thirds in interest of the stockholders of said corporation having voting powers, either in person or by proxy duly constituted attorneys in fact, thereunto duly authorized in writing.

10

Henry L. Rupert
Notary Public, Westchester County
Certificate Filed in New York County.
New York County No. 8
and
New York Register No. 5060
Commission expires March 30th, 1915.

(SEAL)

PORTO RICAN AMERICAN TOBACCO COMPANY,
a corporation organized and existing under and by virtue
of the laws of the State of New Jersey, by its President
and Secretary, DOES HEREBY CERTIFY:

20

I. That the principal office of the company is at No. 104 First Street, Jersey City, New Jersey, and that the agent therein in charge thereof and upon whom process against the corporation may be served is C. A. HOPMAN.

II. The Board of Directors of said corporation at a meeting duly convened on the 20th day of April, 1906, passed a resolution declaring that it was advisable to increase the capital stock of the company to TWO MILLION DOLLARS, and calling a meeting of the stockholders to take action thereon.

30

III. That a copy of said resolution of the Board of Directors is hereto appended.

IV. That thereafter, on the 12th day of May, 1906, pursuant to such call of the Board of Directors, and upon notice given to each stockholder, as provided in the

40

Bill of Complaint—Schedule A.

By-Laws, a special meeting of the stockholders of the company was held, at which meeting more than two-thirds in interest of the stockholders having voting powers, to wit; stockholders holding 3570 shares out of a total of Four thousand (4000) shares issued, were present in person or represented by proxy, and that more than
 10 two-thirds in interest of the stockholders having voting powers, to wit: stockholders holding 3520 shares out of a total of Four thousand (4000) shares issued, voted in favor of such increase of stock.

V. That at said meeting of the stockholders, such increase was assented to in writing by more than two-thirds in interest of the stockholders having voting powers, to wit: stockholders holding 3520 shares out of a total of Four thousand (4000) shares issued, which said written assent is hereto appended.

20 VI. That 4000 shares of stock of said corporation are issued and outstanding.

IN WITNESS WHEREOF, the said PORTO RICAN-AMERICAN TOBACCO COMPANY has caused this certificate to be signed by its President and its Secretary, and its corporate seal to be hereto affixed, this 26th day of May, 1906.

PORTO-RICAN AMERICAN TOBACCO COMPANY,

By L. Toro, President.

A. H. Noble, Secretary.

30

(SEAL)

WE, the undersigned subscribers and stockholders of PORTO-RICAN AMERICAN TOBACCO COMPANY, a corporation organized and existing under and by virtue of the laws of the State of New Jersey, severally owning the number of shares of stock set opposite our respective names, and owning and representing in the aggregate more
 40 than two-thirds in interest of the existing stock of said

Bill of Complaint—Schedule A.

corporation, DO HEREBY CONSENT that the capital stock of PORTO-RICAN AMERICAN TOBACCO COMPANY may be increased to TWO MILLION DOLLARS (\$2,000,000) by adding ONE MILLION FIVE HUNDRED THOUSAND DOLLARS (\$1,500,000) to the existing capital stock; such increase of ONE MILLION FIVE HUNDRED THOUSAND DOLLARS (\$1,500,000) to be 10
in the stock of this company and divided into Fifteen thousand (15,000) shares of the par value of One hundred dollars (\$100) each; so that the total amount of the capital stock after such increase shall be Two Million Dollars (\$2,000,000), divided into Twenty thousand (20,000) shares of the par value of One hundred dollars (\$100) each.

IN WITNESS WHEREOF, we have hereunto subscribed our names and set opposite thereto the number of shares of stock of PORTO-RICAN AMERICAN TOBACCO COMPANY held by us respectively, this 12th day of May, 20
1906.

Names	No. of Shares	
R. B. Arrington	20	
American Cigar Co.	1334	
by A. H. Burroughs, Proxy		
The American Tobacco Company	1329	
by A. H. Burroughs, Proxy		
A. H. Noble	10	30
by G. P. Stacy, Proxy		
John Frenze	25	
by G. P. Stacy, Proxy		
M. A. Walker	10	
by G. P. Stacy, Proxy		
M. Perez Fernandez	10	
by G. P. Stacy, Proxy		
N. Santini	1	
by G. P. Stacy, Proxy		
Manuel Otero	47	40
by G. P. Stacy, Proxy		

Bill of Complaint—Schedule A.

	Angela Usera de Hernandez	10
	by G. P. Stacy, Proxy	
	Charles N. Strotz	2
	by G. P. Stacy, Proxy	
	H. Catlin	2
	by G. P. Stacy, Proxy	
10	W. R. Irby	336
	by G. P. Stacy, Proxy	
	Mrs. W. P. Gilmore	7
	by G. P. Stacy, Proxy	
	E. S. Edwards	50
	by G. P. Stacy, Proxy	
	J. P. Duke	109
	by G. P. Stacy, Proxy	
	B. N. Duke	106
	by G. P. Stacy, Proxy	
20	R. E. Christie.....	1
	by G. P. Stacy, Proxy	
	Emmet Boyd	9
	by G. P. Stacy, Proxy	
	J. B. Cobb	2
	by G. P. Stacy, Proxy	
	Wm. Porter	100
	Total	3520

30 RESOLUTIONS OF THE BOARD OF DIRECTORS.

RESOLVED: That it is advisable that the Capital Stock of this Company be increased to Two Million Dollars (\$2,000,000) by adding One Million, Five Hundred Thousand Dollars (\$1,500,000) to the existing Capital Stock, such increase in stock to be in the general stock of the Company, divided into Fifteen Thousand (15,000) shares of One Hundred Dollars (\$100) each, so that the total amount of stock of the Company shall be Two Million Dollars (\$2,000,000) all general stock divided into

Bill of Complaint—Schedule A.

Twenty Thousand (20,000) shares of One hundred dollars (\$100) each; and that upon obtaining the assent in writing and the approving vote at a meeting of two-thirds in interest of the stockholders of the Company, as required by law, the Capital Stock of the Company be increased by the addition of Fifteen Thousand (15,000) shares of the par value of One Hundred Dollars (\$100.) per share: 10

RESOLVED, FURTHER: That a special meeting of the Stockholders of the Company be, and it is hereby, called to be held on Saturday, the twelfth day of May, 1906, at 11 o'clock a. m., at the principal office of the Company, 104 First Street, Jersey City, New Jersey, for the purpose of considering and voting on such proposed increase of the Capital Stock of the Company, and that due notice of such meeting be mailed by the Secretary twenty days prior to such meeting:

RESOLVED, FURTHER: That the proper officers of the Company be, and they are hereby directed to do all things required to carry the foregoing resolutions into effect. 20

ISLAND OF PORTO RICO }
DEPARTMENT OF SAN JUAN } ss.

BE IT REMEMBERED, that on this 26th day of May, 1906, before me, the subscriber, Herminio Diam a Notary Public in and for the Department of San Juan, Island of Porto Rico, personally appeared A. H. Nobel Secretary of PORTO-RICAN AMERICAN TOBACCO COMPANY, the corporation mentioned in and which executed the foregoing certificate, who being by me duly sworn on his oath says that he is such Secretary: and that the seal affixed to the said certificate is the corporate seal of said corporation, the same being well-known to him; that Luis Toro is President of said corporation, and signed said certificate and affixed said seal thereto, and delivered said certificate, by authority of the Board of Directors 30 40

Bill of Complaint—Schedule A.

of said company, and with the assent of more than two-thirds in interest of the stockholders of said corporation having voting powers, as and for his voluntary act and deed and the voluntary act and deed of said corporation, in presence of deponent, and thereupon subscribed his name thereto as witness,

- 10 AND he further says that the assent thereto appended is signed by more than two-thirds in interest of the stockholders of said corporation having voting powers, either in person or by proxy duly constituted attorneys in fact, thereunto duly authorized in writing.

Herminio Diam,
Notary Public.

(SEAL)

Endorsed:

- 20 Filed and Recorded Jun. 9, 1906,
S. D. DICKINSON,
Secretary of State.

STATE OF NEW YORK }
COUNTY OF NEW YORK } ss.

No. 8223

- 30 I, WILLIAM F. SCHNEIDER, Clerk of the County of New York, and also Clerk of the Supreme Court for the said County, the same being a Court of Record, Do
HEREBY CERTIFY, that Henry L. Rupert whose name is subscribed to the deposition or certificate of the proof or acknowledgment of the annexed instrument, and thereon written, was, at the time of taking such deposition or proof and acknowledgment, a Notary Public, acting in and for said County, duly commissioned and sworn, and authorized by the laws of said State to take depositions and also acknowledgments, and proofs of Deeds, or conveyances for land, tenements or hereditaments in said
40 State of New York. That there is on file in the Clerk's

Bill of Complaint—Schedule A.

Office of the County of New York, a certified copy of his appointment and qualification as Notary Public of the County of Westchester with his autograph signature. And further, that I am well acquainted with the handwriting of such Notary Public, and verily believe that the signature to said deposition, or certificate of proof or acknowledgment is genuine.

10

IN TESTIMONY WHEREOF, I have hereunto set my hand and affixed the seal of the said Court and County this 25th day of March, 1915.

(SEAL)

Wm. F. Schneider,
Clerk.

(10¢ I. R. Stamp Can.)

Endorsed:

“Filed and Recorded Mar. 26, 1915,

20

DAVID S. CRATER,
Secretary of State.”

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Bill of Complaint—Schedule A.

PORTO RICAN AMERICAN TOBACCO COMPANY.

Certificate of Charter Amendment.

Porto Rican American Tobacco Company, a corporation organized and existing under and by virtue of the laws of the State of New Jersey, by its president and assistant secretary does hereby certify:

10

I. That the principal office of the company is at 15 Exchange Place, Jersey City, New Jersey, and that the agent therein and in charge thereof upon whom process against the corporation may be served is The Corporation Trust Company.

20

II. That the Board of Directors of said corporation at a meeting duly convened on the 3rd day of February, 1921, passed a resolution declaring that it was advisable to increase the capital stock of the company to \$10,000,000 by adding \$5,000,000 of capital stock divided into 50,000 shares of the par value of \$100 each and identical in all respects with the capital stock now issued and outstanding and calling a meeting of the stockholders to take action thereon.

III. That a copy of said resolution of the board of directors is hereto attached.

30

IV. That thereafter on the 10th day of March, 1921, pursuant to such call of the board of directors and upon due notice, given to each stockholder of the company a special meeting of the stockholders of the company was held, at which meeting more than two-thirds in interest of the stockholders of the company, to-wit, stockholders holding 38,113—shares out of a total of—49,673-1/2 shares of such stock issued and outstanding were present in person or represented by proxy, and that more than two-thirds in interest of the stockholders, to-wit, stockholders holding 38,113 shares out of a total of—49,673-1/2 shares issued and outstanding voted in favor of such increases in stock and of the same being issued by the

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Bill of Complaint—Schedule A.

board of directors when and as in their judgment may be required.

V. That at said meeting of the stockholders such increase was assented to in writing by more than two-thirds in interest of the stockholders of the Company, to-wit, stockholders holding—38,113—shares out of a total of—49,673½ shares issued and outstanding, which assent in writing is hereto appended. 10

VI. That—49,673½ shares of stock are issued and outstanding, the same being all of one class.

IN WITNESS WHEREOF said Porto Rican American Tobacco Company has caused this certificate to be signed by its president and its assistant secretary and its corporate seal to be hereto affixed this 10th day of March, 1921.

PORTO RICAN AMERICAN TOBACCO COMPANY, 20

By L. Toro,
President.

(SEAL)

H. Catlin,
Assistant Secretary.

Resolution adopted at the meeting of the Board of Directors of Porto Rican-American Tobacco Co. held on February 3rd, 1921. 30

RESOLVED: That it is advisable that the capital stock of this Company be increased to \$10,000,000. by adding \$5,000,000. to the capital stock, such increase to be divided into 50,000 shares of the par value of \$100. each, so that the total amount of stock of the Company shall be \$10,000,000. divided into 100,000 shares of the par value of \$100. each, all of one and the same class; and that a special meeting of the stockholders be and the same is hereby called to be held on the 10th day of March, 1921, at two o'clock P. M. at the principal office of the Com- 40

Bill of Complaint—Schedule A.

pany, 15 Exchange Place, Jersey City, N. J., for the purpose of considering and taking action on said proposed increase of the capital stock of the Company and that due notice of such meeting be given and that upon obtaining the assent in writing and the approving vote of two-thirds in interest of the stockholders of the Company as required by law, the capital stock of the Company be increased as hereinabove provided and that the certificate of incorporation be amended accordingly.

PORTO RICAN AMERICAN TOBACCO COMPANY.

Assent of Stockholders to amendment of Charter.

We, the undersigned subscribers, holders of the capital stock of Porto Rican American Tobacco Company, a corporation organized and existing under and by virtue of the laws of the State of New Jersey, and owning and representing in the aggregate more than two-thirds in interest of such capital stock, do hereby consent as follows:

I. That the capital stock of Porto Rican American Tobacco Company may be increased from \$5,000,000 to \$10,000,000 by adding \$5,000,000 of stock, divided into 50,000 shares of the par value of \$100 each, and to be in form identical with and in all respects of the same class and character and subject to the same terms and conditions as the capital stock of the company now outstanding.

II. That the Board of Directors be and it is hereby authorized and empowered to issue such authorized additional stock when and as in their judgment may be required.

WITNESS our hands this 10th day of March, 1921.

Names	No. of Shares.
H. Catlin	1
H. Catlin, As Proxy	38,112

Bill of Complaint—Schedule A.

STATE OF NEW YORK }
 COUNTY OF NEW YORK } ss.

Be it remembered that on the 10th day of March, 1921, before me the subscriber James H. Ford, a notary public in and for the County of Westchester, in the State of New York and whose certificate is filed in the County of New York, State of New York, personally appeared H. Catlin, Assistant Secretary of Porto Rican American Tobacco Company the corporation mentioned in and which executed the foregoing certificate, who being by me duly sworn on his oath said that he is such assistant secretary; that the seal affixed to the said certificate is the corporate seal of said corporation, the same being well known to him; that Luis Toro is the President of said corporation and signed said certificate by authority of the Board of Directors of said Company and with the assent of more than two-thirds in interest of the stockholders of said corporation, as and for his voluntary act and deed and the voluntary act and deed of said corporation, in presence of deponent and subscribed his name thereto as witness. 10 20

And he further says that the written assent of stockholders appended to the foregoing certificates is signed by more than two-thirds in interest of the stockholders of said corporation either in person or by their severally duly constituted attorneys in fact thereunto duly authorized in writing.

H. CATLIN. 30

Subscribed and sworn to before me
 the day and year aforesaid.

Jas. H. Ford,
 Notary Public, Westchester County,
 Certificate filed in New York County No. 40 (SEAL)
 New York Register's No. 2018.
 Commission Expires March 30, 1922.

Bill of Complaint—Schedule A.

STATE OF NEW YORK, } ss.
 COUNTY OF NEW YORK. }

No. 52129 Series B

10 I, WILLIAM F. SCHNEIDER, Clerk of the County of New York and also Clerk of the Supreme Court in and for said County, Do HEREBY CERTIFY, That said Court is a court of Record, having by law a seal; that Jas. H. Ford whose name is subscribed to the annexed certificate of proof of acknowledgment of the annexed instrument was at the time of taking the same a NOTARY PUBLIC acting in and for said county, duly commissioned and sworn, and qualified to act as such; that he has filed in the Clerk's Office of the County of New York a certified copy of his appointment and qualification as Notary Public for the County of Westchester with his autograph signature; that as such Notary Public, he was duly authorized by the laws of the State of New York to protest notes; to take and certify 20 depositions; to administer oaths and affirmations; to take affidavits and certify the acknowledgment and proof of deeds and other written instruments for lands, tenements and hereditaments, to be read in evidence or recorded in this state; and further, that I am well acquainted with the handwriting of such Notary Public and verily believe that his signature to such proof or acknowledgment is genuine.

30 IN WITNESS WHEREOF, I have hereunto set my hand and affixed the seal of said Court at the City of New York in the County of New York, this 10 day of Mar. 1921.

Wm. F. Schneider,
 Clerk.

(SEAL)

ENDORSED:

"FILED AND RECORDED MAR 11 1921

THOMAS F. MARTIN
 Secretary of State."

Bill of Complaint—Schedule A.

STATE OF NEW JERSEY.

(Seal)

Department of State.

I, THOMAS F. MARTIN, Secretary of State of the State of New Jersey, Do HEREBY CERTIFY that the foregoing is a true copy of Certificate of Incorporation and all Amendments thereto 10

of

“Porto Rican-American Tobacco Company”
as the same is taken from and compared with the originals Filed Sep. 22, 1899, June 9, 1906, Mar. 26, 1915 and Mar. 11, 1921, and now remaining on file and of record in my office.

IN TESTIMONY WHEREOF, I have hereunto
(SEAL) set my hand and affixed my Official seal at 20
Trenton, this fourth day of April, A. D.
1923.

THOMAS F. MARTIN,
Secretary of State.

*Bill of Complaint—Schedule B.***Schedule B.**

Jersey City, N. J. February 21st, 1923.

Treasurer's Report to the Stockholders of Porto-Rican-American Tobacco Company of New Jersey.

10 The Treasurer respectfully submits the following financial report of your Company for the year ended December 31st, 1922.

There has been no change during the year in the amount of authorized Capital Stock (\$10,000,000.00 par value), though additional stock of the par value of \$7,700.00 was issued in exchange for scrip and fractional certificates surrendered, making the amount of Capital Stock outstanding at the end of the year \$6,277,850.00.

20 There were purchased and cancelled during the year \$456,000.00 par value of our 8% Sinking Fund Gold Bonds, leaving a balance outstanding at the end of the year of \$2,385,500.00 of the original issue of \$3,000,000.00. The difference between par value and cost of the Bonds so purchased has been written off as an expense.

While the results from operations during the latter part of the year were very satisfactory, they were not sufficient to offset losses from operations earlier in the year.

30 The statement herewith presented is a consolidated statement of this Company's business with that of its subsidiaries, all of whose stock is owned by this Company.

Gross Profits for the year ended December 31, 1922

\$1,091,636.47

Deduct:

Advertising, Selling, Administrative and other expenses	997,945.54
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Operating Profit	\$93,690.93
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Bill of Complaint—Schedule B.

Add:

Other income	130,422.23	
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Total Income	\$224,113.16	
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Deduct:

Interest on Bonds, Scrip Bills Payable, etc.	\$331,333.23	10
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Inventory Losses	283,018.34	614,351.57
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Net Loss for year	\$390,238.41	
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Add:

Surplus December 31, 1921	399,041.98	
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Surplus December 31, 1922.....	\$8,803.57	
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PORTO RICAN-AMERICAN TOBACCO COMPANY	20
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CONSOLIDATED BALANCE SHEET
December 31st, 1922.

ASSETS:

Real Estate, Machinery, Fixtures, etc.	\$1,968,423.90	
Leaf Tobacco, Manufactured Stock		
Operating Supplies, etc.	4,057,866.75	
Accounts and Bills Receivable	2,018,591.83	
Cash	637,804.24	30
Deferred Charges	170,435.77	
Investment in Other Companies	261,553.32	
Goodwill, Trademarks, etc.	1,500,000.00	
Total Assets	\$10,614,775.81	

Bill of Complaint—Schedule C.

LIABILITIES:

	Capital Stock outstanding	6,277,850.00
	Scrip redeemable in Capital Stock	36,423.00
	Scrip, Series No. 10	149,026.50
	Ten Year 8% Sinking Fund Gold Bonds ...	2,385,500.00
	Accounts and Bills Payable	1,038,880.80
10	Reserved for Depreciation	718,291.94
	Total Liabilities	\$10,605,972.24
	Surplus December 31, 1922	8,803.57

Respectfully submitted,

A. H. NOBLE, Treasurer.

20

Schedule C.

RESOLVED that it is advisable and for the best interest of the Company to so amend the certificate of incorporation and increase its capital stock as that;

(1) The 100,000 shares of capital stock of the par value of One Hundred Dollars (\$100.00) per share now authorized, being all of one class, be changed into a like number of shares of 7% cumulative preferred stock of the par value of \$100. per share, which shall have the following preferences over the non-par value common stock hereinafter referred to, namely:

(a) The holders of said preferred stock shall be entitled to receive in each year out of the accumulated profits of the corporation in excess of such sum, if any, as shall have been fixed and reserved as a working capital a cumulative dividend of 7%, payable quarterly, half-yearly or yearly as the directors may from time to time determine and the same shall be paid before any dividend shall be set aside or paid on the common stock of the corporation;

40

Bill of Complaint—Schedule C.

(b) After said cumulative dividend at the rate of seven per cent. per annum shall have been paid on said preferred stock and after dividends of as much as Seven Dollars per share for the fiscal year shall have been declared and paid on said common stock, then as to all further dividends that may be declared for the fiscal year, the preferred stock and the common stock shall share equally, share and share alike; 10

(c) Upon dissolution of the corporation, or upon final distribution of its assets, and after the payment of its debts, the preferred stock shall be redeemed at par with accumulated dividends, if any, if the assets of the corporation including surplus and accumulated profits, are sufficient. If the assets are not sufficient, then all said assets or their proceeds shall be distributed ratably among the holders of such preferred stock. If the assets are more than sufficient for such redemption, all remaining thereafter shall be divided ratably among the holders of the general or common stock of the corporation; 20

(d) Each share of such preferred stock shall entitle the holder thereof to one vote at all meetings of the stockholders;

(2) There be authorized a total issue of preferred stock as aforesaid to consist of 150,000 shares of such preferred stock of the par value of \$100 per share, whereof the amount necessary at par for the purpose shall be issued to replace the present outstanding stock of the company, as well as the additional amount necessary for the redemption of the outstanding dividend warrants, and the remainder whereof shall be issued from time to time according to law; 30

(3) There be authorized an issue of 150,000 shares of stock without nominal or par value which the Board of Directors may issue as a stock dividend or may sell in whole or in part for such consideration as from time to time may be fixed by the Board of Directors. Every such 40

Bill of Complaint—Schedule C.

share of stock without nominal or par value shall be equal to every other share of such stock of the same class and shall rank as respects the preferred stock according to the preference above stated. Such common stock shall have no voting power.

10 The Board of Directors may issue preferred stock and common stock, respectively, or either, at such times respectively and in such manner as in its discretion may seem best, and upon issuance of preferred stock to subscribers the preferred stockholders shall have preferential right to receive or subscribe for the preferred stock, if any, in proportion to their respective holdings. The right to subscribe for shares of common stock shall be as the Board of Directors may from time to time determine; provided always that if at any time the right to subscribe to said common stock is given to stockholders
20 the holders of both preferred and common stock shall have the right to subscribe thereto in proportion to their respective holdings.

(4) In order that any other class of stock may be authorized, not only the consent of those holding two-thirds of the issued and outstanding shares of preferred stock shall be given, but as well the consent of those holding two-thirds of the issued and outstanding common shares.

30 FURTHER RESOLVED that a special meeting of the stock holders be and the same is hereby called to be held on the 11th day of April, 1923, at eleven o'clock A. M., at the principal office of the company, 15 Exchange Place, Jersey City, New Jersey, for the purpose of considering and taking action on the foregoing resolution for the amendment and increase of capitalization of the certificate of incorporation of the company and that due notice of such meeting be given and that upon obtaining the assent in writing and the approving vote of the stockholders of the company as required by law the certificate of incorporation
40 be amended and the Board of Directors be authorized and empowered to issue stock as hereinabove provided.

Bill of Complaint—Schedule D.

FURTHER RESOLVED that in the event of the certificate of incorporation being amended and the capital of the corporation increased as hereinbefore provided, the Board of Directors shall take such steps as in their judgment may seem best for issuing preferred stock in exchange for the existing stock of the company then outstanding and for this redemption of dividend scrip. 10

A true copy from the minutes.

Attest:

H. CATLIN,
Secretary.

Dated March 22, 1923.

(CORPORATE SEAL)

Schedule D.

20

PORTO RICAN-AMERICAN TOBACCO COMPANY

185 MADISON AVENUE

N. E. Cor. 34th Street

NEW YORK, N. Y.

March 22, 1923.

To the Stockholders of Porto Rican-American Tobacco Company: 30

Recently Tobacco Products Corporation, which had for some time manifested a purpose to enter the field of Porto Rican cigars, made an offer to invest over \$1,500,000 in cash in your Company on substantially the following basis: (1) The present stock of your Company to be converted into a full voting 7% cumulative preferred stock of the same par value as the present stock, namely, \$100 per share, and to participate with the common stock after dividends of \$7 per share have been paid on each class of 40

Bill of Complaint—Schedule D.

stock; (2) an issue of preferred stock to be created for this purpose; and (3) a further issue of non-voting common stock without nominal or par value to be created, whereof Tobacco Products Corporation would buy as many as 64,566 shares at \$25 per share, being equal to the number of shares of existing stock now outstanding, plus the number of shares necessary to redeem outstanding dividend warrants.

This proposition commended itself to the President as being in the interest of the stockholders because it would add \$25 of security to each share of your stock without any loss of control on your part (and without even any participation in control on the part of others); and at the same time would serve to put your stock on a regular and permanent dividend paying basis.

After weighing the proposition carefully, the same was placed before the Board of Directors, which determined to take the steps necessary to accept the offer and carry the plan into effect, subject to approval by the stockholders. With this letter you will receive a notice of a special meeting to pass on these resolutions, together with a copy of the resolutions.

You will notice that the non-par value common stock has no voting power and consequently the control of the company will not be affected, but will remain with the present stockholders. The participation by the preferred stock is also an attractive feature. The situation which will thus be created promises to materially expand your Company's business.

Your Board considered it desirable to take authority at the present time for the issue of preferred and common stock in excess of present requirements so as to provide for the Company's possible needs from time to time with growth and expansion of the business.

Bill of Complaint—Schedule E.

Your favorable action is recommended. It is for the stockholders, however, to determine what course they regard as best calculated to serve their interests.

Very respectfully,

L. TORO,
President.

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Schedule E.

PORTO RICAN-AMERICAN TOBACCO COMPANY
185 MADISON AVENUE
N. E. Cor. 34th Street
NEW YORK, N. Y.

May 10, 1923.

To the Stockholders of Porto Rican-American Tobacco Company:

20

Notice is hereby given that a Special Meeting of the stockholders of said Company will be held at the Company's principal office, 15 Exchange Place, Jersey City, New Jersey, at eleven o'clock A. M., on Thursday, May 31, 1923, for the purpose of considering and acting upon the following resolutions adopted by the Board at a meeting held on the 3rd day of May, 1923, and for the transaction of such other business as may properly come before the meeting:

30

"RESOLVED: That it is advisable and for the best interest of the Company to so amend the certificate of incorporation and increase its capital stock as that:

(1) In addition to the present authorized capital stock of 100,000 shares of the par value of \$100 per share, all of one class (hereinafter referred to as Class A common stock only for the purpose of differentiating it in these resolutions from the proposed new common stock de-

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Bill of Complaint—Schedule E.

10 nominated Class B common stock), there be authorized an issue of 100,000 shares of Class B Common stock, without nominal or par value and without voting power, which the Board of Directors may issue in their discretion in whole or in part to the holders of Class A Common stock as a stock dividend, or offer to them the right to subscribe for same, or otherwise dispose of in accordance with law. Said Class B common stock shall enjoy the privileges and be subject to the further following restrictions and conditions:

20 (a) That when and not until cumulative dividends of seven per cent. shall have been paid upon Class A common stock there may be paid dividends in the aggregate equal to \$7.00 per share on Class B common stock for the fiscal year. As to all further dividends that may be declared for the fiscal year, Class A common stock and Class B common stock shall share equally, share and share alike.

30 (b) Upon dissolution of the corporation, or upon final distribution of its assets, and after the payment of its debts, Class A common stock shall be redeemed at par with accumulated dividends, if any, if the assets of the corporation, including surplus and accumulated profits, are sufficient; if the assets are not sufficient, then all said assets or their proceeds shall be distributed ratably among the holders of Class A common stock. If the assets are more than sufficient for such redemption, all remaining thereafter shall be distributed ratably amongst the holders of said two classes of common stock.

(2) The Board of Directors may issue any authorized and unissued Class A common stock and Class B common stock, or either, at such times, respectively, and on such terms as in its discretion may seem best and in accordance with law, and upon issuance of Class A common stock the holders of Class B common stock shall not have any preferential right to receive or subscribe for the same.

Bill of Complaint—Schedule E.

(3) In order that any other class of stock may be authorized, not only the consent of those holding two-thirds of the issued and outstanding shares of Class A common stock shall be given, but as well the consent of those holding two-thirds of the issued and outstanding Class B common stock.

FURTHER RESOLVED: That a special meeting of the stockholders be and the same is hereby called to be held on the 31st day of May, 1923, at eleven o'clock A. M., at the principal office of the Company, 15 Exchange Place, Jersey City, New Jersey, for the purpose of considering and taking action on the foregoing resolution for the amendment and increase of capitalization of the certificate of incorporation of the Company and that due notice of such meeting be given and that upon obtaining the assent in writing and the approving vote of the stockholders of the Company as required by law, the certificate of incorporation be amended and the Board of Directors be authorized and empowered to issue stock as hereinabove provided. 10 20

FURTHER RESOLVED: That in the event of the certificate of incorporation being amended and the capital of the corporation increased as hereinabove provided, the Board of Directors be empowered to forthwith give to the holders of Class A common stock the privilege of subscribing and taking one share of Class B common stock for each share of Class A common stock held by them, respectively, in consideration of \$25.00 per share." 30

In the event of your being unable to be present at the meeting, you are requested to kindly sign and return the enclosed proxy immediately. The proper revenue stamp will be affixed by the company.

Very respectfully yours,

H. CATLIN,

Secretary. 40

*Bill of Complaint—Schedule F.***Schedule F.**

PORTO RICAN-AMERICAN TOBACCO COMPANY

185 MADISON AVENUE

N. E. Cor. 34th Street

NEW YORK, N. Y.

10

May 10, 1923.

To the stockholders of Porto Rican-American Tobacco Company:

Your Board of Directors on the 13th March, 1923, adopted certain resolutions, calling a special meeting of the stockholders and recommending that the charter of the Company be amended increasing the authorized capital stock; the conversion of the present stock of the Company into seven per-cent cumulative preferred stock; the issuing of a like number of shares of common stock without nominal or par value and disposing of the latter without first offering it to the present stockholders.

Some of the stockholders strongly insisted that the right to take the non-par common stock should be given to the stockholders in proportion to their holdings of the present outstanding stock.

Out of deference to the views of the stockholders opposing the plan, your Board of Directors reconsidered and rescinded the resolutions calling for a Special Meeting of the stockholders and definitely abandoned the plan, and in lieu thereof they are now proposing the new plan evidenced by resolutions of the Board adopted on May 3, 1923, a copy of which is set out in the notice herewith enclosed calling the Special Meeting of stockholders on May 31, 1923. Amongst other things, it appears from these resolutions that the Board recommends that the charter be amended so as to authorize the increase of the capital stock of the Company, the same being all of one class, by adding thereto 100,000 additional shares desig-

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Bill of Complaint—Schedule F.

nated as Class B common stock without nominal or par value or voting rights, and that there be offered to the present stockholders one share of Class B common stock at \$25.00 per share for each share of the present stock held by them, respectively. It is deemed but proper that you be advised that the entire surplus of the Company has been consumed. It is of great importance that necessary working capital be provided, and it is for the purpose of raising the same that the Company is seeking to sell an additional amount of stock of the Company. 10

Due to the several bad years experienced by the Company, mainly attributable to labor conditions in Porto Rico, your Company, as you will recall, sought and secured in 1921, at a time when there was great stringency in the money market a loan of \$3,000,000, for which it issued its Ten Year Gold Bonds at the then prevailing high rate of eight per-cent interest. There was a provision for a sinking fund, through which up to the present, something more than the required number of bonds have been purchased and retired. The bonds are redeemable at any semi-annual interest due date. We submit that the Company should be relieved as quickly as is practicable of continuing to carry the burden of interest on these bonds. Besides, your Company needs additional working capital for the general expansion of its business and especially for the purchase of the present crop of tobacco, which is of good quality. To the extent it can acquire tobacco of the present crop at fair and reasonable prices, it is sought to be good policy to invest in the same, to the extent of the needs of the Company. 20 30

It is the hope and desire of your Board of Directors that the stockholders will appreciate the conditions, and promptly respond to the notice of the special meeting of stockholders to consider and act upon the resolutions of the Board.

Very respectfully yours,

L. TORO, 40
President.

*Bill of Complaint—Schedule G.***Schedule G.**

PORTO RICAN-AMERICAN TOBACCO COMPANY
185 MADISON AVENUE
NEW YORK, N. Y.

February 21st, 1923.

10

To the Stockholders of Porto Rican-American Tobacco Company:

As you will see by the Treasurer's Report for the year 1922, your Company has passed through a trying period of reconstruction and depression and is now operating at a profit.

20 While the Treasurer's Report shows losses of \$390,-238.41, after depreciation of inventories, your Company has been operating at a profit since October 1st, 1922, and every indication points to bigger and better business for the year 1923.

Profits from operations during the last quarter, before depreciation, have been about \$150,000., and there is every reason to believe your Company will show substantial profits in 1923.

Respectfully yours,

L. TORO.

President.

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Bill of Complaint—(Hochster, et al.).

BILL OF COMPLAINT.

Filed.

IN CHANCERY OF NEW JERSEY.

*To the Honorable Edwin Robert Walker, Chancellor of
the State of New Jersey:*

10

Complainants William Rice Hochster, Margaret R. Thompson, W. Roosevelt Thompson and Alice Moffitt Pulleyn, all of the City, County and State of New York, complaining against Porto Rican-American Tobacco Company, a corporation of the State of New Jersey, say:

1. Complainants are stockholders in Porto Rican-American Tobacco Company, a corporation organized and existing under the laws of the State of New Jersey, and bring this bill on behalf of themselves and such of the other stockholders of said corporation as will come in and contribute to the cost of this suit.

20

2. Defendant Porto Rican-American Tobacco Company was incorporated under the General Corporation laws of the State of New Jersey on September 22, 1899, with objects and powers as stated in its Certificate of Incorporation, hereby tendered to the court, marked Schedule A.

3. The authorized capital stock of defendant as fixed by its charter was \$500,000.

30

This was increased to \$2,000,000 by amendment certificate filed June 9, 1906.

Said authorized stock was thereafter further increased to \$5,000,000. by amendment certificate dated March 25th, 1915.

Said authorized capital stock was thereafter further increased to \$10,000,000. by amendment certificate filed March 11, 1921.

All of said stock is of one class, namely common stock, divided into shares of the par value of \$100. each.

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Bill of Complaint—(Hochster, et al.).

The amount of stock now issued and outstanding is \$6,277,850.

4. Complainant William Rice Hochster is the holder and owner of 126 shares of said stock.

Complainant Margaret R. Thompson is the holder and owner of 103 shares of said stock.

10 Complainant W. Roosevelt Thompson is the holder and owner of 60 shares of said stock.

Complainant Alice Moffitt Pulleyn is the holder and owner of 455 shares of said stock.

All of said complainants were such holders and owners of record long prior to the acts complained of.

5. The defendant corporation controls, through stock ownership, the following companies:

20 Porto Rican-American Tobacco Co. of Porto Rico, incorporated in Porto Rico, with \$10,000,000. authorized capital stock of which \$6,860,000, has been issued, all of which is owned by the defendant corporation. This subsidiary owns and operates all the properties in Porto Rico formerly owned by the defendant corporation, consisting of ten factories for the manufacture of cigars and cigarettes in Porto Rico.

30 New York-Tampa Cigar Co., incorporated in Delaware, with an authorized capital stock of 15,000 shares common of no par value and \$500,000. preferred of \$100. This subsidiary acquired the business and assets of M. Alvarez & Co. and the Industrial Co. of Porto Rico. All the common and the preferred stock of this company was issued to the defendant corporation, which owns over 60% of the common and all of the preferred stock. Its cigar manufacturing plants are located at Perth Amboy, New Jersey, and Tampa, Florida.

40 Porto Rican Leaf Tobacco Co., incorporated in New Jersey with \$500,000. capital stock, par \$100. This company grows the entire available supply of Porto Rican

Bill of Complaint—(Hochster, et al.).

shade tobacco wrapper leaf. The defendant corporation owns 50% of the capital stock.

6. The defendant corporation is the most important factor in the Porto Rican tobacco industry and is one of the largest manufacturers of cigars in the United States. Since the establishment of its business in 1897 it has grown from a production of 3,000,000 cigars and little cigars and 500,000 cigarettes in 1899 to nearly 250,000,000 cigars and little cigars and nearly 500,000,000 cigarettes in 1920. The cigars are sold throughout the United States under well-known brands. The cigarettes are sold almost exclusively in Porto Rico where the company does about 90% of the cigarette business of the Island. 10

7. The defendant corporation, for the seventeen years from 1904 to 1920, inclusive, has paid dividends in scrip and stock averaging over 20% per annum, as follows: 1904, 8%; 1905, 31½%; 1906, 84%; 1907, 10½%; 1908, 5%; 1909, 9%; 1910, 14%; 1911 and 1912, 16% each; 1913, 17%. In December, 1912, an extra dividend of 20% was paid in scrip and in March, June, September and December 1913 and 1914 and in March, 1915, scrip distributions of 5% each were made, all of said scrip dividends being redeemable in cash or stock at par, at the Company's option. In June, 1915, cash dividends were resumed by payment of 4%, which rate was regularly paid to June, 1917, inclusive; in September and December, 1917, scrip dividends of 4% each were paid; in June, September and December, 1918, March and June, 1919, March, June, September and December, 1920, and March, 1921 dividends of 3% each were paid in three-year scrip. Stock dividends have been paid as follows: 10% on December 7, 1916, and 4% on March 7, 1918. 20 30

8. The policy of the defendant corporation during the past ten years has been to conserve its cash resources by declaring scrip dividends, redeemable in three years thereafter in cash or stock at the option of the company, 40

Bill of Complaint—(Hochster, et al.).

and the company has generally exercised that option by redeeming in stock, thereby greatly adding to its resources and providing the additional working capital required for the expansion of its business.

10 From time to time the capital stock has been issued to redeem an equal amount of such dividend scrip, including the scrip paid in 1920. Of its present outstanding stock of \$6,277,850. over 45%, or \$2,894,420. represents the issue at par of stock in exchange for scrip, and on December 31, 1922, there was outstanding scrip redeemable in capital stock of \$36,423. and scrip of March, 1921, of \$149,026.50.

20 9. The only funded debt of the defendant corporation on December 31, 1922, was \$2,385,500. ten year 8% sinking fund gold bonds of a total authorized of \$3,000,000. dated May 15, 1921, which was issued to fund outstanding floating debt and to increase working capital, the company having sustained a very large loss during the preceding twelve months through strikes and the great deflation in merchandise values of that period, as hereinafter more fully set forth. These bonds are subject to call as a whole, but not in part, on any interest date on 30 days' notice at 107½ on or before May 15, 1926, and at 105 thereafter, and as a sinking fund the company agreed to set aside in each semi-annual period a sum sufficient to purchase \$150,000. face value of bonds if obtainable at prices not exceeding 105 and interest, all bonds so purchased to be cancelled. On December 31, 1922, there was 30 outstanding \$2,385,500. of said bonds, which at the time of the commencement of this action had been reduced to about \$2,174,500, all of which is substantially in excess of the sinking fund provisions.

40 10. For 1921 the defendant corporation showed a loss for the first time in its existence, when through labor troubles all its factories were closed for nine months and it was obliged radically to write down all inventories at the close of the year. This unusual loss amounted to

Bill of Complaint—(Hochster, et al.).

\$2,392,363. and necessitated the issuance of the aforesaid \$3,000,000. ten year bonds, for the purpose of funding the resulting floating indebtedness. On March 3, 1922, L. Toro, as President, sent a letter to the stockholders of the company explaining this loss, as follows:

“March 3rd, 1922.

To the Stockholders of Porto Rican American Tobacco Company:

10

The year ending December 31, 1921 has been most harrowing and disappointing, and the first year in the existence of your company in which a loss has been shown.

Your company for a number of years past has had more or less labor troubles. It has not been able to work continuously for any year during the last five years.

The unjust demands of labor culminated in December, 1920, when it became impossible to continue operating under the conditions that existed, and your Board of Directors then decided that drastic action was necessary to protect your interests and insure the future welfare of the brands of your company, and accordingly, all your cigar factories were closed in January, 1921. Since that date and up to September, 1921, a period of nine months, a continuous struggle was waged with labor, which was contending for the closed shop, but finally by the end of September your company succeeded in gaining its point and started manufacturing again on the open shop basis. It is gratifying to be able to advise that very little labor trouble has occurred since.

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Wages were not reduced until December 1, 1921, for in order to win the strike, it was necessary to maintain the same standard of wages existing during the war period; hence, the few months' operations during the year 1921 were based on the same labor cost as during the war period.

Unfortunately for your company, labor conditions prevented the working of a good deal of the 1920 crop of tobacco, which was the most expensive

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Bill of Complaint—(Hochster, et al.).

crop ever harvested in Porto Rico, and this fact made it necessary to make readjustment of and write down all inventories at the end of the year. Your company is now going through the readjustment period, just as other companies engaged in a like business are doing.

10 The policy of retrenchment has been established in every department and your company hopes to be able to effect still further economies.

Very respectfully,

L. Toro, President."

20 11. The business depression which continued through the first half of 1922 resulted in substantial losses from operations during that period, but the company's business during the latter part of that year showed a satisfactory result, so that the net loss for the year was only \$390,238.41. During the current year the result of operations has been very satisfactory and shows a continuing expansion in business and increase in profits over the latter part of 1922; labor conditions have been satisfactory and the Porto Rico tobacco crop is reported as unusually good, as a result of which the company is making rapid progress in returning to its former highly profitable basis of operations.

30 12. In August, 1912, the stockholders of the defendant corporation authorized a plan whereby 10% of its excess profits over those of 1910 are distributed among the president, vice-presidents and treasurer of said company, and the individuals holding said offices are the beneficiaries of said bonus provisions.

40 13. The Board of Directors of the defendant corporation is composed of Luis Toro, John Frese, F. L. Kenny, A. H. Noble, H. Catlin, H. D. Newton, A. H. Burroughs, H. L. Brown and N. Pasarell, and of these the said Luis Toro is President, John Frese is First Vice-President, F. L. Kenny is Second Vice-President, A. H. Noble is Treasurer and H. Catlin is Secretary and Assistant Treasurer of the defendant corporation.

Bill of Complaint—(Hochster, et al.).

14. Tobacco Products Corporation, a corporation existing under the laws of the State of Virginia, with its principal office in the City, County and State of New York, where it has been authorized to do business, is a corporation likewise engaged in the manufacture and distribution of tobacco, cigarettes, etc. Among various subsidiary companies which it controls, through stock ownership, or in which it has a substantial stockholding interest, are the following: Falk Tobacco Co., Khedival Co., M. Melachrino & Co., Inc., The Melachrino Tobacco Trading Co., Inc., Nestor Gianacis Co., Prudential Tobacco Co., Inc., Robert Harris & Bro., Inc., Schinasi Bros., Surbrug Co., Stephano Bros., Inc., Tobacco Products Export Corporation and John J. Bagley & Co. It also controls, through ownership of over 87% of Class A Common and Founders' shares, the United Retail Stores Corporation, which in turn controls the United Cigar Stores Co. of America, which is the principal customer in the United States for the cigars manufactured by the subsidiaries of the defendant corporation.

15. On May 3, 1923, the Board of Directors of the defendant corporation adopted and passed resolutions to the effect that it was advisable and for the best interests of the said corporation to amend its certificate of incorporation and increase its capital stock so that in addition to the present authorized capital stock of 100,000 shares of the par value of \$100 per share, and all of one class (therein and hereinafter referred to as Class A common stock for the purpose of differentiating same in said resolutions from the proposed new common stock therein and hereinafter denominated Class B common stock), there be authorized an issue of 100,000 shares of Class B common stock without nominal or par value and without voting power which the Board of Directors might issue in their discretion in whole or in part to the holders of Class A common stock as a stock dividend or offer to them the right to subscribe for same or otherwise dispose

Bill of Complaint—(Hochster, et al.).

of in accordance with law and that the said Class B common stock should enjoy the privileges and be subject to the restrictions and conditions as more fully set forth in said resolutions and in a copy of said resolutions of the said Board of Directors sent out by said defendant corporation under date of May 10, 1923, a copy of which is
10 hereto annexed and made a part hereof, marked "Schedule B". As appears from said "Schedule B", notice is thereby given to the stockholders of the defendant corporation that a special meeting of its stockholders will be held at the Company's principal office, 15 Exchange Place, Jersey City, New Jersey, at 11:00 o'clock A. M. on Thursday, May 31, 1923, for the purpose of considering and acting upon the said resolutions adopted as aforesaid by the Board of Directors of the defendant corporation on the third day of May, 1923.

20 16. On or about May 10, 1923, the defendant corporation mailed to its stockholders then of record a proxy for execution by the stockholders, naming Luis Toro, A. H. Burroughs and H. Catlin or any of them as attorneys to vote at such special meeting. Said Luis Toro, the President, A. H. Burroughs, one of the Directors and Counsel, and H. Catlin, Secretary and Assistant Treasurer of the defendant corporation, who are stockholders in said Company, have solicited and received and hold
30 proxies from stockholders of the said company, authorizing them to vote stock in favor of the aforesaid proposed amendment of the certificate of incorporation of the defendant corporation at the said special meeting of the stockholders of the defendant corporation to be held at Jersey City, New Jersey, called for the 31st day of May, 1923.

40 17. For the purpose of the proposed amendment of the certificate of incorporation and the intent of said defendant corporation with respect to the distribution of the capital stock to be then authorized is to convert the present stock of the defendant corporation, all of which

Bill of Complaint—(Hochster, et al.).

is common stock, into a full voting 7% cumulative preferred stock of the same par value of the present stock, namely, \$100. per share, which will be entitled to participate with the Class B common stock after dividends of \$7.00 per share had been paid on each class of stock. On the Class B common stock without nominal or par value to be created, the defendant corporation has declared that Tobacco Products Corporation will buy at \$25. per share as many as 64,566 shares, being equal to the number of shares of the existing stock now outstanding plus the number of shares necessary to redeem the outstanding dividend warrants of the defendant corporation. 10

18. As more fully appears by its consolidated balance sheet dated December 31, 1922, hereby tendered to the Court, the defendant corporation at that time had current assets consisting of leaf tobacco, manufactured stock, operating supplies, etc., at \$4,057,866., accounts and bills receivable \$2,018,591. and cash \$637,804., a total of \$6,734,261. and at the same time its liabilities for current accounts and bills payable aggregated \$1,038,880. which is approximately \$6.50 in current assets to every dollar of liability and in addition it has had cash available voluntarily to purchase and cancel its 8% ten year gold bonds in substantial excess of the sinking fund provisions for redeeming same. 20

19. The said Tobacco Products Corporation has made an offer to invest over \$1,500,000. in cash in the defendant corporation by buying 64,566 shares of the new or Class B common stock which it is proposed to authorize at \$25 per share. Provided the said contemplated amendment to the Certificate of Incorporation is perfected, the said defendant corporation proposes to sell, and the said Tobacco Products Corporation proposes to purchase, the said shares of new or Class B common stock at that price, or so many thereof as are available after the present 30 40

Bill of Complaint—(Hochster, et al.).

stockholders have exercised the option to subscribe for said Class B common stock given them by said amendment.

10 20. No part of the money which, according to the proposed plan, is to be invested by said Tobacco Products Corporation in the said defendant corporation is required by the latter as additional working capital, and the purpose behind and the inevitable result of the intended amendment of the certificate of incorporation of the defendant corporation and the plan to have Tobacco Products Corporation acquire said shares of the new or Class B common stock, is not in the interest of the defendant corporation or its stockholders, but is in the interest of said Tobacco Products Corporation, which for an investment of about \$1,600,000 will be entitled to receive the same total return in dividends as the issued and now outstanding stock of \$6,456,600. par value, subject only to the priority of payment of 7% dividends on such issued and now outstanding stock.

20 21. On or subsequent to May 10, 1923, the defendant corporation mailed to its stockholders then of record, a circular letter from Luis Toro, President, to the stockholders of the defendant corporation, likewise dated May 10, 1923, explaining the intent with respect to the amendment of the certificate of incorporation; a copy of said circular letter is annexed hereto and made a part hereof marked "Schedule C."

30 To the said circular letter and to the aforementioned proxies the complainants for greater certainty beg leave to refer.

40 22. The complainants charge that this proposed scheme and plan were conceived and are being put into effect with the knowledge, acquiescence and in concert with the officers of the defendant corporation, by a certain group which owns and controls with those closely associated with it the majority stock of the defendant cor-

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poration and of the Tobacco Products Corporation, which latter controls the United Retail Stores Corporation, which in turn controls the United Cigar Stores Co. of America, which is the principal customer of the cigar product of the defendant corporation.

23. The complainants further charge that sufficient majority of the capital stock of the defendant corporation is controlled by the directors thereof and those closely associated with them, to approve at the stockholders' meeting the resolutions of the board of directors to amend the capital stock provisions of the company as stated in said notice unless restrained by this Honorable Court. 10

24. The complainants allege that the proposed scheme to amend the capital stock provisions of the Certificate of Incorporation is contrary to law and to the power of said corporation and is detrimental to the rights of its stockholders; that a transaction of this kind, even with the consent of a majority of the stockholders would be contrary to equity and good conscience, and would be an unlawful use and abuse of corporate property and of the stockholders' vested rights; and is *ultra vires* and beyond the power of the defendant corporation as against the objection of any stockholders; that the complainants, as stockholders, object to the consummation of said scheme and charge that the same is *ultra vires* the defendant corporation and in fraud of their rights as such stockholders; that the proposed amendment to the charter of the defendant corporation changes the fundamental arrangement and plan of the corporation and violates the contractual rights of stockholders, in that under the charter of said corporation and the laws existing at the time of its incorporation, there were no provisions authorizing an amendment of the charter to permit the issuance of stock without nominal or par value or the involuntary conversion of stock of one class into 20 30 40

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10 stock of another class; that said proposed amendment is in effect confiscatory of the stockholders' rights and interest in the corporation and compels stockholders against their consent and wishes to surrender their contractual rights as to dividends and a distribution of the corporate assets on dissolution for stock rights of an entirely different class and character, limited as to dividends and distribution of corporate assets in the event of dissolution; that the said proposed amendment and the proposed scheme further violates the rights of stockholders and is contrary to the charter of the defendant corporation and laws of the State of New Jersey, in that it will permit the issuance to the Tobacco Products Corporation of a substantial portion of the common stock, with dividend rights of 28% for each \$100. paid for the new or Class B common stock, after paying 7% on the present or Class A stock of \$100. par value, which the present stockholders will be compelled to accept in substitution of their present rights, and as to any additional distribution of dividends there will be 4% paid on each \$100. invested in new or Class B common stock to each 1% paid on each \$100. of the present or Class A common stock. The complainants also allege that prior to its labor disturbances and closing of factories due to strikes in 1921, the capital stock of the defendant corporation sold at over \$150. per share, but as a result of the losses of 1921, the market price of the stock declined to under \$50 a share. Following the publication of its annual report as of December 31, 1922, the market price of the stock advanced to \$92. a share on March 15, 1923, but since the publication of the proposed plan of its directors, the price has declined to \$78. per share, at which price it sold during the week ended May 26, 1923, on the New York Stock Exchange.

25. The complainants further charge that the said amendment is in further violation of the stockholders' rights in that it permanently places in the hands of the

Bill of Complaint—(Hochster, et al.).

Board of Directors unlimited discretion as to the time and manner in which and the consideration for which so much of the proposed new issue of 100,000 shares of Class B common stock as is not subscribed for by its present stockholders may be issued and sold, all in violation of the General Corporation Act of the State of New Jersey and particularly of section 121 thereof. 10

26. The complainants further charge that the said amendment is in violation of section 18 of the General Corporation Act of New Jersey in that forasmuch as the proposed amendment contemplates that there shall be issued and outstanding 100,000 shares of the present or Class A stock and 100,000 shares of the new or Class B common stock and contemplates that said Class A stock shall become in fact and in law a preferred stock as defined in said section, it results that the total amount of said preferred stock issued and outstanding would, after the consummation of said plan, exceed two-thirds of the capital stock of the defendant corporation paid for in cash or property. 20

27. The complainants further charge that the said amendment is in violation of section 18 of the General Corporation Act of New Jersey in that forasmuch as the said amendment contemplates that the present or Class A common stock shall become in fact and in law a preferred stock as defined in said section, the amendment provides that said Class A common stock shall not only receive cumulative dividends of 7% per annum but shall also, after Class B common stock shall have received dividends in the aggregate equal to \$7.00 per share, receive an equal share with Class B common stock in all further dividends that may be declared for the same year and may thus receive dividends exceeding eight per centum per annum. 30

28. The complainants further allege that the proposed amendment and the scheme contemplated by the Directors 40

Bill of Complaint—(Hochster, et al.).

10 of the said defendant corporation either among themselves and other stockholders thereof or in connection with other parties and particularly the said Tobacco Products Corporation are in violation of the Anti-Trust laws of the United States and particularly of the Sherman Act and of the Clayton Act and especially of section 7 of the Clayton Act in that the intent, purpose and object of the proposed amendment is to permit the said Tobacco Products Corporation to acquire directly or indirectly a substantial part of the new or Class B common stock of the defendant corporation and that the effect of such acquisition may be substantially to lessen competition between the defendant corporation and the said Tobacco Products Corporation and tend to create a monopoly in the manufacture and sale of Porto Rican tobacco, cigars and cigarettes.

20 29. The complainants further allege that the purpose and intent of withholding from the new or Class B common stock voting rights is to further a scheme or device on the part of the defendant corporation, its officers and directors and on the part of the said Tobacco Products Corporation to evade the Anti-Trust Laws of the United States and particularly section 7 of the Clayton Act, and that in truth and in fact the said Tobacco Products Corporation will on the consummation of the said proposed plan, in conjunction with other stockholders of the defendant corporation allied in interest and acting in concert with said Tobacco Products Corporation obtain control of the defendant corporation notwithstanding the withholding from the new or Class B common stock of voting rights.

30 30. The complainants further allege that the holders of a large majority of the stock of the said defendant corporation, including its directors and those associated with them, have authorized or are about to authorize said Toro, Burroughs and Catlin, as proxies, to vote at said special stockholders' meeting in support of the said pro-

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Bill of Complaint—(Hochster, et al.).

posed plan for the purpose of bringing it into effect, in violation of the rights of the complainants and other stockholders dissenting therefrom, unless restrained by this Honorable Court; that the complainants have declined to give proxies, as requested, for the said special meeting, or to assent to any of the proposed acts to be done by the proxies, or to the proposition submitted in the notice and circular letter hereinabove referred to, (Schedules B and C), and that they do now protest against such acts of the said proxies and against any ratification or confirmation by the stockholders of the acts of the directors of the said defendant corporation and the attempted adoption of the proposed plan, including the sale of any shares of the defendant corporation to the said Tobacco Products Corporation. 10

31. The complainants further allege that the directors of the defendant corporation have wrongfully and unlawfully conspired together to do the things hereinabove mentioned at the proposed stockholders' meeting to be held at Jersey City, N. J., on the 31st day of May, 1923, as alleged, or at any adjourned time thereafter, and that they have endeavored to secure the control of a sufficient amount of capital stock of the defendant corporation now outstanding either by person or by proxy to have the same represented at said meeting and voted in favor of the plan above set forth unless restrained by this Honorable Court. 20 30

32. Complainants show that it would be futile to request the Board of Directors of the defendant corporation to commence this suit or to seek this relief, inasmuch as said Board of Directors have passed the resolution and called the meeting for adoption of the amendment to the charter to which complainants object.

Bill of Complaint—(Hochster, et al.).

Complainants are without adequate remedy in the courts of law, and therefore pray:

1. That the defendant, Porto Rican-American Tobacco Company, may answer this bill of complaint and each statement therein made.
- 10 2. That defendant, Porto Rican-American Tobacco Company, its directors, officers, agents, tellers and inspectors, may be enjoined and restrained from submitting to the stockholders of the defendant corporation at the meeting of the said stockholders to be held on the 31st day of May, 1923, or at any adjournment thereof, or at any other meeting, the proposition to take action upon the resolution of the Board of Directors of the said defendant corporation adopted and passed May 3rd, 1923, as fully set forth in Schedule "B" annexed to this Bill, and that they be enjoined and restrained from passing
20 any resolution or receiving or counting any votes in favor of any resolution designed to carry into effect or accomplish any such proposition and from taking any steps or means whatever toward effecting or perfecting the accomplishment thereof.
3. That the complainant may have such other and further relief as to the Court may seem just.
4. That a writ of subpoena may issue, commanding said defendant to answer this bill of complaint, and to
30 abide by such decree as this Court may make in the premises.

MERRITT LANE,
Solicitor for and of Counsel
with Complainants.

Bill of Complaint—(Hochster, et al.).

STATE OF NEW YORK,
CITY AND COUNTY OF NEW YORK, SS:

WILLIAM RICE HOCHSTER, of full age, being duly sworn according to law, on his oath says:

I am one of the complainants named in the foregoing bill of complaint and have carefully read the same.

The allegations thereof, so far as they relate to my own acts or matters within my own knowledge, are true, and so far as they relate to the acts of others I believe them to be true. 10

I am the holder and owner of 126 shares of the capital stock of the defendant Porto Rican-American Tobacco Company.

The copy of certificate of incorporation annexed was obtained for me by my attorneys and I am informed and believe is a true copy, taken from a copy certified by the Secretary of State of New Jersey. 20

The documents annexed as schedules "B" and "C" are copies of documents received by me through the mail, purporting to come from the office of Porto Rican-American Tobacco Company and addressed to me as a stockholder thereof.

The statements therein made as to the history, dividends and financial condition of the company are based in part upon notices and communications received by me from the corporation and also dividends received by me from the corporation, and in part upon the allegations of a bill of complaint filed in the Court of Chancery of New Jersey by one Philip M. Grausman, complainant, against the Porto Rican-American Tobacco Company, defendant. 30

WM. RICE HOCHSTER.

Bill of Complaint—(Hochster, et al.).

Sworn and subscribed before me, a
Notary Public of the State of New
York, duly commissioned and quali-
fied to take oaths and affirmations in
the County and State aforesaid, this
29th day of May, 1923.

10 SUMNER L. SAMUELS,
Notary Public, New York County,
Clerk's No. 22, Register's No. 4032,
Commission expires March 30th, 1924.
(SEAL)

STATE OF NEW YORK,
CITY AND COUNTY OF NEW YORK, ss:

CHARLES H. PARSONS, being duly sworn according to law,
on his oath says:

20 I am the attorney and agent in this behalf of the com-
plainants Margaret R. Thompson and W. Roosevelt
Thompson.

I have carefully read the foregoing bill of complaint
and say that I verily believe the statements therein made
to be true.

The said Margaret R. Thompson is the holder and owner
of 103 shares and W. Roosevelt Thompson is the holder
and owner of 60 shares of the capital stock of the de-
30 fendant corporation, as above stated.

CHARLES H. PARSONS.

Sworn and subscribed before me, a
Notary Public of the State of New
York, duly commissioned and sworn
and qualified to take oaths and
affirmations in the County and State
aforesaid, this 29th day of May, 1923.

SUMNER L. SAMUELS,
40 Notary Public, New York County,
Clerk's No. 22, Register's No. 4032,
(Notarial Seal) Commission expires March 30th, 1924.

Bill of Complaint—(Hochster, et al.).

STATE OF NEW YORK,
CITY AND COUNTY OF NEW YORK, ss:

ALICE MOFFITT PULLEYN, of full age, being duly sworn according to law, on her oath says:

I am one of the complainants named in the foregoing bill of complaint and have carefully read the same.

The allegations thereof, so far as they relate to my own acts or matters within my own knowledge, are true, and so far as they relate to the acts of others I believe them to be true.

I am the holder and owner of 455 shares of the capital stock of the defendant Porto Rican-American Tobacco Company.

The documents annexed as schedules "B" and "C" are copies of documents received by me through the mail, purporting to come from the office of Porto Rican-American Tobacco Company and addressed to me as a stockholder thereof.

ALICE MOFFITT PULLEYN.

Sworn and subscribed before me, a Notary Public of the State of New York, duly commissioned and qualified to take oaths and affirmations in the County and State aforesaid, this 29th day of May, 1923.

SUMNER L. SAMUELS,
Notary Public, New York County,
Clerk's No. 22, Register's No. 4032,
Commission expires March 30th, 1924.

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Bill of Complaint—(Hochster, et al.).

Schedules annexed to the Bill of Complaint in the Hochster case are not printed because the same schedules are annexed to the Bill of Complaint in the Grausman case as follows:

	Hochster case	Grausman case
	Schedule "A"	Schedule "A"
10	" "B"	" "E"
	" "C"	" "F"

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Order to Show Cause.

A true copy

McCARTER & ENGLISH,
Solicitors of Complainants.

ORDER TO SHOW CAUSE.

Filed May 29, 1923

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IN CHANCERY OF NEW JERSEY.

Between

PHILIP M. GRAUSMAN,

Complainant,

and

PORTO RICAN-AMERICAN TOBACCO COM-
PANY,

Defendant.

On Bill, &c.

*Order to Show
Cause.*

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This matter being opened to the Court by McCarter & English, Solicitors for and of counsel with the complainant, and the Bill of Complaint, Exhibits and Affidavits having been considered and filed.

IT IS, on this 29th day of May, 1923, on motion of McCarter & English, Solicitors as aforesaid, ORDERED that the defendant, Porto Rican-American Tobacco Com-
pany show cause before the Chancellor at the Chancery Chambers in the City of Newark, on the 5th day of June, 1923, at ten o'clock in the forenoon or as soon thereafter as counsel can be heard, why an injunction should not issue as prayed for in the said Bill of Complaint.

AND IT IS FURTHER ORDERED in the meantime and until the further order of this Court, that defendant, Porto-Rican-American Tobacco Company, its directors, officers, agents, tellers and inspectors, may be enjoined and re-

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Order to Show Cause.

10 strained from submitting to the stockholders of the defendant corporation at the meeting of the said stockholders to be held on the 31st day of May, 1923, or at any adjournment thereof, or at any other meeting, the proposition to take action upon the resolution of the Board of Directors of the said defendant corporation adopted and passed May 3rd, 1923, as fully set forth in Schedule "B" annexed to this Bill, and that they be enjoined and restrained from passing any resolution or receiving or counting any votes in favor of any resolution designed to carry into effect or accomplish any such proposition and from taking any steps or means whatsoever toward effecting or perfecting the accomplishment thereof.

20 AND IT IS FURTHER ORDERED that a true copy of this Order and of the said Bill, Exhibits and Affidavits, be served upon the defendant herein within 3 days from the date hereof by leaving the same with its registered agent in the State of New Jersey, or by serving the same upon any officer of the said defendant, either within or without the State of New Jersey, and that all of the aforesaid copies may be certified to be true copies by the solicitors of the complainant.

E. R. WALKER,
C.

30 Respectfully advised,
JOHN H. BACKES,
V. C.

Order to Show Cause.

ORDER TO SHOW CAUSE.

Filed May 29, 1923.

IN CHANCERY OF NEW JERSEY.

WILLIAM RICE HOCHSTER, *et als.*,

Complainants,

vs.

PORTO RICAN-AMERICAN TOBACCO COM-
PANY,

Defendant.

On Bill, &c.

Order.

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Upon reading and filing the verified bill of complaint of the complainants in above-entitled cause,

IT IS, on this 29th day of May, 1923, on motion of MERRITT LANE, of counsel with complainants,

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ORDERED that the defendant corporation show cause before the Chancellor, at the Chancery Chambers in the City of Jersey City, on the 8th day of June, 1923, at the hour of ten o'clock in the forenoon or as soon thereafter as counsel can be heard, why the defendant corporation should not be enjoined and restrained from amending its certificate of incorporation and issuing capital stock in pursuance of a plan set forth in complainant's bill, and why the stockholders of defendant corporation and their respective agents, attorneys and proxies should not be enjoined and restrained from voting in approval of said plan at the meeting of said stockholders on May 31, 1923, or at any adjournment thereof.

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FURTHER ORDERED that in the meantime and until the further order of the Court the defendant corporation and its several stockholders and their several attorneys, agents and proxies, be enjoined and restrained from voting in approval of the proposed amendment of the certificate of incorporation of defendant company pursuant to the

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Order to Show Cause.

resolution of the Board of Directors of the corporation dated May 3, 1923, and from signing any assent to any such amendment, and from taking any action on said proposed amendment either at the meeting of stockholders on May 31, 1923, or at any continuation or adjournment thereof.

- 10 Nothing herein contained shall prevent said stockholders from convening said meeting and adjourning the same from time to time.

FURTHER ORDERED that copies of this order and of the bill of complaint and affidavit herein referred to which copies may be certified by the solicitor for the complainants, be served upon the defendant within two days from the date hereof.

E. R. WALKER.

- 20 Respectfully advised,
 JOHN BENTLEY,
 V.-C.

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Affidavit of Luis Toro.

ANSWERING AFFIDAVITS.

IN CHANCERY OF NEW JERSEY.

Between

PHILIP M. GRAUSMAN,

Complainant,

and

PORTO RICAN-AMERICAN TOBACCO COMPANY,

Defendant.

WILLIAM RICE HOCHSTER, *et als.*,

Complainants,

and

PORTO RICAN-AMERICAN TOBACCO COMPANY,

Defendant.

On Bill, &c.

*Answering
Affidavits.*

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STATE OF NEW YORK, }
COUNTY OF NEW YORK, } ss.

LUIS TORO, of full age, being duly sworn according to law, on his oath says:

1. I am the President of Porto Rican-American Tobacco Company, the defendant in the above suits, and have been the President of said company since its organization in 1899. I own 489 shares of the stock of said company which stand in my name on its books, and am the equitable owner of 1,100 additional shares. 30

2. The defendant is an independent corporation and is engaged through its subsidiaries in the manufacture of cigars and cigarettes. It markets its cigars principally in the United States, while its cigarettes are sold almost exclusively in Porto Rico. 40

Affidavit of Luis Toro.

3. The capital stock of the defendant is widely distributed, it having 519 stockholders. None of its capital stock is held by the Tobacco Products Corporation or by any of the companies mentioned in the bills of complaint as being owned or controlled by the said Tobacco Products Corporation.

10 4. The business of the defendant has been successfully conducted from the time of its organization until the beginning of the year 1921, although since June, 1917, it has not been in a condition which warranted the payment of any cash dividends and has therefore paid no cash dividends since that time.

20 5. For several years prior to January 1, 1921, the defendant had experienced labor troubles which culminated on said date in the suspension of all manufacturing operations at all of its Porto Rican factories, which suspension continued until on or about September 1st of said year.

6. During the year 1920 the defendant invested heavily in tobacco of the crop of said year, which was purchased at the abnormally high prices then prevailing and which subsequently proved to be of inferior quality.

30 7. Because of the suspension of manufacturing operations from January 1, 1921, to September 1, 1921, as aforesaid, the defendant was unable to manufacture and sell during such year the tobacco so purchased of said 1920 crop. During this period the price of tobacco steadily declined, so that by the end of 1921 the market price of the stock then on hand had been reduced by 50% of its cost value. Such stock had also seriously deteriorated in quality to the extent that the defendant was obliged to abandon its use and to sell it in the market at the best price obtainable. This entailed a very severe loss.

40 8. As a result of the suspension of its manufacturing operations, the defendant was unable to supply the de-

Affidavit of Luis Toro.

mand for its products and consequently its gross sales for the year 1921 were less than \$8,000,000. as compared with gross sales of \$15,706,765. during the year 1920.

9. Many of the cigars manufactured by the defendant during the year 1920 were of inferior quality, due to poor workmanship occasioned by the labor troubles and due to the inferiority of the tobacco, which did not become apparent until after the cigars had been marketed. Because of this condition the defendant was obliged, during the year 1921, to accept the return of large quantities of such cigars which had been sold during said year, thereby sustaining a heavy loss. 10

10. Due to the circumstances hereinbefore detailed the company sustained a loss during the year 1921 of \$2,704,394.92, and the principal brands of the company suffered a severe loss of prestige, which has seriously affected the business of the company. During the year 1920 the defendant sold 113,000,000 cigars of its two leading brands. In 1921 the sale of cigars of same brands totaled only 52,000,000, entailing a loss of 54% as compared with the business of the previous year in such brands. These brands represented 70% of the cigar sales of the defendant. 20

11. On December 31, 1920, the defendant had a floating indebtedness of \$3,050,000.00. The condition of the money market in the spring of 1921 was so abnormal that the defendant was obliged to fund its floating indebtedness by issuing its bonds in the amount of \$3,000,000. payable in ten years, with interest at the rate of 8% per annum. Said bonds were secured by a trust agreement which contains sinking fund provisions requiring the defendant to purchase and retire \$300,000. par value of such bonds each year. A copy of said trust agreement is hereto annexed and marked "Schedule 1". 30

12. Since September 1, 1921, the factories of the defendant have been operating without serious labor troubles. 40

Affidavit of Luis Toro.

Notwithstanding this fact, the defendant has by no means recovered the position which it occupied during the year 1920 and previous years. During the year 1922 its sales of its two leading brands equaled only 55,000,000 cigars, as compared with sales of said cigars in 1920 equaling 113,000,000, representing a loss of 51% as compared with such sales made in 1920.

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13. While the business of the defendant improved materially during the last quarter of 1922, its operations for the entire year were conducted at a loss of \$390,238.41. During the first three months of the current year the business of the defendant has been conducted at a profit of only \$3,205.27.

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14. The successful prosecution of the defendant's business is dependent upon the prestige of the principal brands of cigars sold by it. The reputation of such brands has been built up and maintained by the defendant during a period of more than twenty years by care and skill in the selection and ageing of the tobacco and in the manufacture of the cigars, as well as by extensive advertising of such brands throughout the United States. Such advertising has cost the defendant millions of dollars. The cigars sold under such brands had steadily and constantly grown in favor with the consuming public until the year 1921. If the business of the defendant is to succeed it will be necessary to restore said brands to popular favor. In order to accomplish this result, it is essential that the defendant conduct immediately an extensive advertising campaign which during the next six months will entail a cost of at least \$500,000. Such campaign has already been commenced. Contracts have been made for advertising during the months of June and July of the current year at a cost of approximately \$175,000. It will be necessary to continue this campaign for at least the balance of the year and probably longer.

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15. On December 31, 1922, the defendant had on hand a stock of only \$762,265.42 of the 1922 crop of tobacco. This

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Affidavit of Luis Toro.

is far below the normal stock of tobacco which the company should carry for the purpose of caring for its business.

16. In order to maintain the character and quality of cigars manufactured by the company and thus restore its brands to popular favor, it is necessary to carry at all times a two years' supply of tobacco so that the tobacco, before being manufactured into cigars, may be properly cured. During the year 1922 the defendant, because of lack of working capital, was unable to purchase more than one-half of its normal supply of Porto Rican tobacco of that year's crop and consequently at the end of said year it had on hand a stock of only \$762,265.42 of such crop. If the defendant had been able to secure sufficient funds with which to purchase the necessary supplies of tobacco from said 1922 crop, it would have had on hand on December 31, 1922, a stock of said crop of a value of at least \$1,500,000. The defendant's present stock of tobacco does not exceed one-half of its normal requirements and it does not have and cannot procure the necessary funds with which to replenish such stock.

17. I have been in Porto Rico on two occasions during this spring and find that the crop of Porto Rican tobacco for the current year is of exceptionally good quality. It is imperative that the defendant immediately make large purchases from said crop if its business is to be successfully prosecuted

18. It will be necessary for the defendant to have at least \$1,000,000. additional capital for the purpose of making purchases of tobacco of the present crop.

19. During the past two years and a half the defendant has not had sufficient funds to make any additions, repairs or improvements to its fixed properties, as it has been obliged to conserve every dollar of its cash for working capital. Good business practice requires that it should have funds available for the purpose of making such repairs, additions and improvements as occasions arise.

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20. As shown by the consolidated balance sheet, dated December 31, 1922, copy of which is hereto annexed and marked "Schedule 2," the defendant on the date last mentioned had current assets consisting of leaf tobacco, manufactured stock, operating supplies, etc., of \$4,057,866. For the three years up to and including the year 1920 the average investment of the defendant at the close of each year in leaf tobacco and other raw materials, including manufactured stock, has been \$5,968,398.61, which is the quantity of such materials which the defendant normally should have had on hand at the close of the year ending December 31, 1922, and which it would have had on hand at the close of said year had it had sufficient capital.

21. The complainants allege that the said statement dated December 31, 1922, shows that the defendant, at that time, had approximately \$6.50 in current assets to every dollar of liability. This statement is misleading because the complainants ignore the liability of the defendant on its outstanding bonds amounting to \$2,385,500. When said liability is taken into consideration the current assets of the defendant are in the ratio of 1.92 to each \$1. of liabilities, and on March 31, 1923, the current assets of the defendant were in the ratio of 1.85 to each \$1. of liabilities.

22. As appears from the foregoing, the defendant urgently needs at least \$1,500,000. of additional capital for immediate use in defraying the cost of necessary advertising and in purchasing a stock of tobacco of the present crop. It is impracticable for the defendant to borrow this sum because of the provisions of Section 24 of the trust agreement securing its outstanding bonds. This provision is as follows:

"Section 24. So long as any of the Bonds remain outstanding and unpaid, the Company will at all times maintain current assets (as defined in Section 50 hereof) at an aggregate amount equal to at least 175 per-cent of the aggregate amount of

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all liabilities, including the aggregate principal amount of the Bonds issued and outstanding hereunder, and will at all times maintain net current assets (as defined in Section 50 hereof) at an aggregate amount equal to at least 200 per-cent of the aggregate principal amount of such outstanding Bonds."

On March 31, 1923, the current assets of the defendant as defined in section 50 of said mortgage were \$6,845,992.09, and its liabilities, including the amount of outstanding bonds secured by said trust agreement amounted to \$3,701,201.84. On said date it was therefore unable to borrow as much as \$500,000. without defaulting under said Section 24 of said trust agreement. Furthermore if the liabilities of the defendant had been increased in the sum of \$250,000.00, without an increase in current assets, the defendant would have been in default under said provisions.

23. While the defendant has 37,183½ shares of its authorized capital stock which have not yet been issued, it is impracticable to raise the requisite additional capital by issuing and selling said shares, or any of them. Its stock is listed and dealt in on the New York Stock Exchange. Early in the year 1923, such stock sold on the New York Stock Exchange at from \$65. to \$70. per share. It was, therefore, impossible for the defendant to attempt to raise the necessary additional capital by offering its unissued stock for sale at its par value of \$100. per share.

24. At this juncture the Tobacco Products Corporation proposed to the defendant that if it would have its charter amended so as to convert its present authorized capital stock into preferred stock and authorize an issue of 150,000 shares of non-par common stock said Tobacco Products Corporation would purchase 62,778 shares of said non-par common stock at the price of \$25.00 per share.

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25. Defendant's Board of Directors, believing that the acceptance of said offer would benefit defendant and would enable it to secure the additional capital which it needed and that it would meet with the approval of its stockholders, accepted said offer, subject, however, to the defendant securing the necessary two-thirds vote of its stockholders in favor of said amendment, and thereafter on March 13, 1923, said Board of Directors passed the resolution providing for such amendments.

26. Said Board of Directors, upon discovering that the proposed amendment did not meet with the approval of some of its stockholders, for the alleged reason that such stockholders desired that said new stock be offered to the present stockholders instead of being sold to Tobacco Products Corporation, determined to abandon such plan. Thereupon the said resolutions of the Board of Directors calling the meeting of stockholders for the purpose of passing upon such proposed amendment were rescinded on April 30, 1923. The proposed plan was definitely and finally abandoned and the conditional agreement above mentioned made between Tobacco Products Corporation and defendant was cancelled on the date last named.

27. After the abandonment of the plan above mentioned and the cancellation of the agreement between Tobacco Products Corporation and defendant, the Board of Directors of defendant were obliged to devise some method by which the necessary additional capital could be secured. After careful consideration said Board reached the conclusion that the plan outlined in the notice addressed to stockholders dated May 10, 1923, copy of which is hereto attached and made a part hereof and marked "Schedule 3," was the only feasible method available to the company for raising the necessary additional capital.

28. The resolutions recited in the said notice were thereupon adopted by said Board and the said notice duly mailed to each of the stockholders of record of said

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defendant, accompanied by a letter from the President bearing the same date, addressed to the stockholders, explaining the plan and the necessity for its adoption, copy of which letter is hereto attached and marked "Schedule 4." The facts set forth in said letter, including the statement that the entire surplus of the defendant has been consumed, are true. As above stated and as shown by the consolidated balance sheet of the defendant dated December 31, 1922, its surplus at that time was only \$8,803.57, the defendant having lost by its operations during the years 1921 and 1922, the sum of \$3,094,633.33, which had for all practical purposes wiped out its surplus. 10

29. I believe that as stated in said letter, the investment of the stockholders in defendant will be impaired unless additional capital shall be secured in accordance with the present plan. It is true that in the letter addressed by me to the stockholders on February 21, 1923, I stated that the company had every indication of bigger and better profits for the year 1923. Those expectations have not been realized. On the contrary, for the first quarter of the year 1923, the operations of the company show a profit of only \$3,205.27. 20

30. It is alleged in paragraph 10 of the bill of complaint filed by the complainant Grausman that the loss sustained by the defendant during the year 1921 was \$2,392,365. This figure represents the net operating loss. In order to ascertain the actual loss sustained by the defendant during said year it is necessary to add the interest on bills payable and outstanding scrip and interest on its bond issue amounting to \$312,031.92 to the net operating loss, making the actual loss sustained during said year \$2,704,394.92. 30

31. With reference to the allegation contained in paragraph 13 of said bill, the arrangement therein referred to is embodied in a By-law of the corporation which was adopted by the stockholders and is repealable by them. 40

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On only two occasions since the adoption of said By-laws has the profits realized by the company exceeded those of 1910, and on those occasions the amount distributed under said By-laws was insignificant.

32. I have no knowledge of the names of the companies owned or controlled by the Tobacco Products Corporation, and so far as I am informed and believe
10 neither the Tobacco Products Corporation nor any of the corporations owned or controlled by it is engaged in the manufacture of cigars.

33. Complainant Grausman has alleged in paragraph 20 of his bill that it was in consequence of defendant's recognition of the invalidity of its said first plan and its abandonment thereof, that he, with the consent of the defendant, dismissed his former complaint. This is not only misleading, but it is untrue. Said complainant,
20 without in any way being approached or induced to do so by defendant or any one authorized to act for it, voluntarily dismissed his bill of complaint on the 24th of April, 1923, leaving the defendant free, so far as he was concerned, to adopt said resolutions, thereby putting through its first plan at its adjourned meeting of stockholders then to be held on the following Monday, April 30th, 1923. The defendant did not abandon its said first plan until the morning of April 30, 1923, when it learned that the
30 plan was objectionable to some of its stockholders other than said Grausman because they were not allowed to take the new stock, at which time it was served with notice of suit filed by Hochster and others, the identically same complainants appearing in the second above-entitled cause. The directors of the defendant were impressed with the apparent desire of a substantial minority of its stockholders to take and pay for the new stock and, therefore, concluded to and did entirely abandon its first plan and adopted a new one which it believed would recommend itself to all the stockholders, which new plan was subse-
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quently expressed in the resolutions of the Board of Directors passed May 3, 1923.

34. The statement contained in paragraph 22 of said bill,

“that a sufficient majority of the capital stock of the defendant corporation is controlled by the Directors thereof and those closely associated with them to approve at the stockholders’ meeting the resolution of the Board of Directors to amend the capital stock provisions of the Company as stated in said notice,”

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is untrue. The following is a list of the stockholdings of the respective members of the Board of Directors:

Name	Number of shares.
L. Toro	1589
John Frese	1338
F. L. Kenney	18
N. Pasarell	53
A. H. Noble	568
H. L. Brown	1
A. H. Burroughs	1324
R. M. Byrnes	1
H. D. Newton	1
H. Catlin	10

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I am informed and believe that none of the members of the Board of Directors control any stock except that respectively owned by them as above set forth.

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35. The allegations contained in paragraph 24 of said bill to the effect that the present proposed plan is an effort by subterfuge and evasion to create a situation which is illegal and void and that the defendant is now endeavoring under a different guise and in a different manner to obtain the same result proposed in the resolution of March 13, 1923, to the detriment of the present stockholders, are untrue. As above stated, the plan proposed in the resolution of March 13, 1923, has been finally

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and definitely abandoned, and the sole purpose of the present plan is to provide the necessary additional capital for the defendant in a manner which will afford to each stockholder an opportunity to secure his proportion of the new stock. It is the hope and desire of the Board that all of the stockholders will subscribe for and take the stock to be allotted to them under said plan. No arrangements of any kind or character have been made by said Board for the sale of said stock in any manner or to any person or corporation except by offering the same *pro rata* to the stockholders as outlined in said resolution.

36. Paragraph 25 of said bill alleging that "following the publication of the financial report of the Company as at December 31, 1922, the market price of its stock advanced to \$92.00 a share" is true but misleading. The plan adopted by the Board of Directors on March 13th, 1923, was announced to the stockholders on March 22nd, 1923, and rumors of its adoption had been prevalent prior to that time. The sale price of the stock of the defendant did not go above 85 until March 27th, 1923, on which date it sold at 96. After the abandonment of the said plan by the defendant the price of the said stock dropped to \$82. and then to \$78. per share.

37. The allegation contained in paragraph 26 of said bill,

30 "that the present plan is in furtherance of the scheme which was more boldly set forth in the plan proposed in the resolution of March 13, 1923, in that it enables a group which controls the defendant corporation, some of whom are also dominant factors in the control of the Tobacco Products Corporation and affiliated companies, to secure a large amount of the proposed Class B Common Stock at a price which will enable them to procure substantially all the benefits of the earnings of the corporation by limiting the dividend rate on the present outstanding Common Stock and providing for the payment of dividends, which, as

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Affidavit of Luis Toro.

already pointed out, would be on the basis of 4% per \$100.00 invested in the Class B Common Stock, and 1% for each \$100.00 invested in the present Common Stock''

is untrue. The defendant is not dominated by any person or group of persons who also dominate or are influential in the business and affairs of the Tobacco Products Corporation. I am fully convinced that there is no group of persons owning stock in the said two companies and that no group of stockholders has attempted to influence the directors in adopting the present or any other plan. I had no object whatever in voting for said resolution except to provide for a fair and practicable method for raising the additional capital which the company must have if it is to regain its former position as a manufacturer of cigars. No stockholder or group of stockholders of the defendant company nor anyone connected with the Tobacco Products Corporation or any of the companies owned or controlled by it or any other outside interest whatsoever, influenced me or attempted so to do with reference to said resolution. I represent no special interest on the Board of Directors and in voting for said resolution I acted solely in the interest of the company and not in the interest of any particular stockholder or group of stockholders or any other individual or corporation whatsoever. I own 441 shares of the Class A stock of the Tobacco Products Corporation and 200 shares of the preferred stock of the United Cigar Stores Company of America. I own no stock in any of the other companies named in the Grausman bill of complaint as being owned or controlled by the Tobacco Products Corporation. So far as I am informed and believe, none of the other directors of the defendant owns any stock in the Tobacco Products Corporation or any of its affiliated companies. I am convinced from my knowledge of the affairs of the company, my acquaintance with the members of the Board of Directors and from what has transpired at the meetings of

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the Board, particularly at said meeting of May 23, 1923, that all of the members of the Board who were present at said meeting voted in favor of said resolution for the same reason. 275 stockholders of the defendant, owning in the aggregate considerably more than two-thirds of its entire outstanding capital stock, have sent their proxies to the officers of the company to be voted in favor of the proposed plan.

38. The facts above stated in this affidavit are intended to apply as well to the allegations contained in the bill filed by the complainant Hochster and others as to the allegations contained in the Grausman bill.

LUIS TORO.

Sworn to and subscribed before me this
20th day of June, 1923.

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JAS. H. FORD,

Notary Public, Westchester County.

Certificate filed, New York County No. 144.

New York County Register's No. 4159.

(SEAL) My commission expires March 30, 1924.

County Clerk's certificate attached.

STATE OF NEW YORK, }
COUNTY OF NEW YORK. } ss.

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HARRY CATLIN, of full age, being duly sworn according to law, upon his oath says:

1. I am the Secretary and Assistant Treasurer and a Director of the Porto Rican-American Tobacco Company, the defendant in the above entitled actions and have held such offices continuously for a period long antedating the institution of such suits. I have been connected with the defendant since 1902.

2. The defendant through its subsidiaries is engaged in the manufacture of cigars and cigarettes; its cigars

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are manufactured principally in Porto Rico and are sold almost exclusively in the United States. The cigarettes are sold almost exclusively in Porto Rico.

3. The defendant's capital stock is widely distributed among five hundred and nineteen stockholders. Neither the Tobacco Products Corporation nor any of the various companies alleged in the bill of complaint to be subsidiaries of or controlled by said corporation is the owner of record of any of the capital stock of the defendant. I believe that none of said companies has directly or indirectly any stock interest whatsoever in the defendant. From the date of its organization until the beginning of 1921, defendant's business was generally successful, although for several years immediately prior to 1921, it had been very much embarrassed and retarded in its operation by labor troubles. Numerous strikes occurred during such years. No cash dividends have been declared or paid by the defendant since June, 1917. 10 20

4. During the latter part of 1920 labor troubles became so acute that the defendant was obliged to close all of its Porto Rican factories on January 1, 1921. All of such factories remained closed until about the first of the September following, during which time the business of the defendant suffered heavily and its brands lost their former prestige. For a considerable portion of this period the defendant's leading brands in important sections of the United States where they had been previously sold exclusively, were entirely off the market. 30

5. The defendant owned and still owns forty or fifty different brands of cigars. Its leading brands and best sellers are RICORO, LA TUNITA, PORTINA and EL TORO. These four brands are in reality the brands upon which the defendant depends for the major part of its revenue. Two of them namely, RICORO and PORTINA, comprised seventy per cent. of the entire sales of the defendant's cigars. 40

Affidavit of Harry Catlin.

6. To take care of the growing and expanding business of the defendant, it purchased during the year 1920, a large stock of leaf tobacco of the crop of that year at the then prevailing abnormally high prices. During the aforesaid period when the defendant's factories in Porto Rico were closed and no leaf tobacco could be used in the manufacture of cigars the market value of the defendant's stock of tobacco declined until at the end of the year 1921 its market value was reduced at least fifty per cent. of its cost price. This tobacco also greatly deteriorated in quality during said period and was subsequently disposed of at a great loss to the defendant. In addition to this loss, the defendant sustained a loss in prestige of its brands and was obliged to take back from its customers large quantities of cigars which had proved unsatisfactory in part by reason of having been made by inferior tobacco and in part by reason of poor workmanship occasioned by the labor difficulties.

7. Without taking into consideration the incalculable damage to the defendant's brands, which will continue for a number of years, the defendant sustained from its operations during the year 1921 a loss of \$2,704,394.92.

8. During the year 1922 the defendant suffered a further loss due manily to the falling off in sales of its leading brands of cigars. This loss is illustrated by the following table comparing sales of cigars of defendant's leading brands in 1918, which was a normal year in the tobacco business, with sales of the same brands made in 1922:

Name of Brand	Sales in 1918	Sales in 1922
EL TORO	27,000,000	19,000,000
PORTINA	32,000,000	18,000,000
LA TUNITA	19,500,000	6,500,000
RICORO	64,500,000	37,500,000

9. The condition of the money market early in 1921 was such that it became necessary for the defendant to

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fund its floating indebtedness amounting to \$3,050,000. This resulted in negotiating a loan to the defendant of \$3,000,000., and on May 15, 1921, the defendant issued its bonds in this amount secured by the trust agreement, a copy of which is hereto annexed and marked "Schedule 1." As hereinbefore stated the loss which the defendant sustained in the years 1921 and 1922 aggregated the sum of \$3,094,633.33, which was substantially in excess of the amount realized by the defendant upon the sale of its said bonds. 10

10. While the business of the defendant during the latter part of 1922 appeared more promising and justified the belief that the company was entering upon a period of prosperity, this idea has been negated by actual results of its business for the first quarter of 1923. The defendant's net earnings for such quarter amount to only \$3,205.27. 20

11. In order to properly conduct the defendant's business it is imperative that it make every reasonable effort to rehabilitate its leading cigar brands and to bring them up to their former standing with the trade and maintain them in that enviable position. This will require time and great care in the selection of the particular quality and grades of tobacco for every particular brand, and great care and skill in the workmanship. It will be necessary to expend large sums in conducting an extensive advertising campaign. Such campaign has been commenced and contracts have been made for advertising during the current month and the month of July at a cost of approximately \$175,000., which is a small portion of the aggregate sum which will necessarily be expended for this purpose in the next few years. A conservative estimate of the amount which must be expended for advertising during the balance of the current year is \$500,000. 30

12. In addition to the said sum of \$500,000. to defray advertising expenses, the defendant must have at least \$1,- 40

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000,000. additional capital for use in purchasing leaf tobacco of the crop of the current year now being sold in Porto Rico. The defendant's present stock of leaf tobacco is less than one-half of its normal requirements, and cannot be materially increased unless a very substantial amount of additional capital shall be secured.

- 10 13. The defendant cannot borrow the necessary working capital of \$1,500,000. which it must have at the present time. An additional bond issue would be out of the question. It is impossible for the defendant to sell additional shares of its present authorized capital stock. These shares are of the par value of \$100. each. They cannot be sold at par because its issued shares are selling on the New York Stock Exchange at considerably less than par at the present time, and have not been sold on the Exchange at or above par since October, 1920. Defendant
- 20 is precluded from raising the necessary working capital, or any considerable part thereof, by borrowing from banks or by selling additional notes by reason of the provision of Section 24 of said trust agreement, which section requires the defendant to have at all times current assets of the value of 1.75 to every dollar of its liabilities, including the principal amount due on its outstanding bonds. On March 31, 1923, such ratio of current assets to liabilities was 1.85 to 1.00. If the defendant should borrow \$500,000. its ratio of current assets to liabilities
- 30 would be reduced below the proportion required to be maintained by Section 24 of said trust agreement.

14. Early in the spring of the current year the Tobacco Products Corporation submitted to the Board of Directors of the defendant, a proposition for the purchase by that company of a substantial amount of defendant's capital stock. Said Board realizing the immediate necessity of acquiring at least \$1,500,000. additional capital and the difficulties confronting them in attempting to secure the same, formulated the plan set

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forth in the resolutions adopted on March 13, 1923. The said plan met with opposition on the part of a small but substantial minority of defendant's stockholders, who expressed their dissatisfaction with it because the proposed new stock was not to be offered to them but was to be sold to outside interests. Thereupon defendant's Board of Directors definitely and finally abandoned said plan on April 30, 1923, by rescinding the resolutions of March 13, 1923, and cancelling the conditional contract for the sale of such stock to Tobacco Products Corporation. 10

15. Upon the abandonment of said plan of March 13, 1923, the Board of Directors were confronted with the necessity of devising another plan for securing additional working capital to meet defendant's imperative needs. After careful consideration said Directors formulated the plan outlined in the resolutions adopted May 3, 1923, believing that it was the only feasible plan that could be adopted by the defendant, and that it would be entirely fair to its present stockholders. Notices of a special meeting of the stockholders to be held on May 31, 1923, to vote upon said plan were sent on May 10, 1923, to each of the stockholders of record. Notwithstanding the institution of the above actions and the extensive publicity given thereto by the Press, 275 of defendant's stockholders, representing considerably more than two-thirds in interest of its outstanding capital stock, have sent their proxies to defendant's officers for the purpose of voting in favor of said plan. 20 30

16. The names and respective places of residence of the persons who constituted defendant's Board of Directors on May 31, 1923, are as follows:

Affidavit of Harry Catlin.

Louis Toro, New York.
 John Frese, Porto Rico.
 A. H. Noble, Porto Rico.
 N. Pasarell, Porto Rico.
 F. L. Kenny, New York.
 A. H. Burroughs, New York.
 H. L. Brown, New York.
 R. M. Brynes, New York.
 H. Catlin, New York.
 H. D. Newton, New York.

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Since May 3, 1923, the said H. D. Newton has resigned as a Director, and Thomas C. Breen has been elected in his stead. Defendant has been unable to secure affidavits from said John Frese, A. H. Noble, R. M. Brynes, N. Pasarell, H. L. Brown and H. D. Newton, because of their absence from New York since prior to the commencement of the pending actions.

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17. The defendant has made no arrangement or agreement of any kind or character for the sale of any of its capital stock proposed to be issued under the resolutions of May 3rd, 1923, to the Tobacco Products Corporation, of any of its affiliated companies, or to any person or corporation, or in any manner, except pro-rata to its stockholders as set forth in said resolutions. It is not true as is alleged in the bills of complaint that a group of defendant's stockholders consisting of its Directors, or some of them, are acting alone or in conjunction with any other parties to adopt a plan by which the Tobacco Products Company or any of its affiliated companies will become interested in the defendant's capital stock. No group of persons is in existence which dominates the defendant company, and also dominates or is interested in the Tobacco Products Corporation, or any of its affiliated companies, and I am informed and believe that no group is in existence which owns stock in the two companies.

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18. In voting for said resolutions of May 3, 1923, I was actuated by no outside influence of any kind or character, but was entirely controlled by what I considered to be for the best interests of the defendant, and its stockholders, and I believe that this is equally true of each of the other Directors who voted for said resolutions. I do not believe that any person or group of persons attempted to influence the Directors to vote for said resolutions. I am convinced from my knowledge of the affairs of the defendant and my acquaintance with the members of its Board of Directors that said resolutions were passed solely in the interest of its stockholders for the purpose of providing sufficient additional capital to enable the defendant to successfully conduct its business. I am also convinced that the interests of such stockholders will be jeopardized if the defendant shall fail to procure such additional capital in the immediate future.

19. It is not true as in effect alleged in the bills of complaint that the market value of the defendant's capital stock has been depressed by the announcement of either the first or second plan for increasing its stock. On the contrary it is true that the stock rose in value on the New York Stock Exchange in anticipation that a plan would be adopted by which fresh capital would be secured. This is evidenced by the fact that on March 27, 1923, which was nearly two weeks after the first plan had been announced, the stock sold on the New York Stock Exchange at \$96. per share, which was higher than it had sold at any time since October, 1920, and eleven points higher than it had sold at any time since February 26, 1921. On April 16, 1923, one week after the rule to show cause why the said plan should not be enjoined had been issued, the price of the stock dropped to \$78. per share.

20. I have read the affidavit of William K. Dupre, Jr., annexed to the bill of complaint filed by the complainant Grausman. The statement therein contained that on March 30, 1923, I told said Dupre that the factories of

Affidavit of Harry Catlin.

10 the defendant "were putting out more and better cigars than at any time in the history of the concern, and that during the last few months of 1922 business had improved and the company had gotten back to a money making basis" is not true. I told Mr. Dupre on this occasion that the defendant was making better cigars than it had made in the past, having reference to the inferior cigars manu-
factured by the defendant during the labor troubles of 1920. I did not tell him that we were making more cigars than at any time in the history of the company, and such is not the fact. I told him that the defendant had made a little money during January of the current year, but did not specify the amount.

20 21. I have read the statement contained in Mr. Dupre's said affidavit that the allegations contained in paragraphs 10 and 11 of the bill of complaint were stated to him by me on the occasion of the above-mentioned interview. Referring to the allegations contained in said paragraph 11 of said bill, I did not tell said Dupre that the result of operations during the current year showed an increase in profits over the latter part of 1922, and such is not the fact. I told said Dupre that there was every indication that the defendant would make profits during the current year. I did not attempt to indicate to him the amount of such profits or assure him that the defendant had been restored to its former highly profitable
30 basis of operations, and such is not the fact. I also stated to said Dupre that the defendant urgently needed a large amount of additional capital. At the time of this conversation I assumed that such additional capital would be speedily secured and based my statement concerning the future profitable operation of the defendant upon this assumption.

HARRY CATLIN.

Affidavit of Thomas C. Breen.

Sworn to and subscribed before me
this 20th day of June, 1923.

(SEAL) JAS. H. FORD,
Notary Public, Westchester County.

Certificate filed New York County No. 144.

New York Register's Number 4159.

My Commission Expires March 30, 1924.

County Clerk's Certificate Attached.

10

STATE OF NEW YORK, }
COUNTY OF NEW YORK. } ss.

THOMAS C. BREEN, being duly sworn according to law, on
his oath says:

1. I am a director of Porto Rican-American Tobacco
Company, the above named defendant, and the auditor of
said company, and as such I am familiar with the accounts
of said company and with its financial and business
affairs. 20

2. The business of the defendant company, which is
the manufacture and sale of cigars and cigarettes, was
successfully and profitably conducted prior to January 1,
1921.

3. On the date last named the defendant was obliged
to close all of its factories in Porto Rico because of labor
troubles, and none of said factories resumed operation
until on or about September 1, 1921. 30

4. Because of the closing of the factories of the de-
fendant and its consequent inability to supply the market
with its cigars, and also because of the poor quality
of the tobacco of the 1920 crop, the sales of the defendant
greatly decreased during 1921. For example, in the year
1920 the total sales of the two leading brands of cigars
manufactured by the defendant amounted to 113,000,000
cigars. In 1921 the total sales of said brands had dropped 40

Affidavit of Thomas C. Breen.

to 52,000,000 cigars, representing a decrease in the sale of said cigars for such year of 54 per cent. The sale of said brands represented approximately 70 per cent. of the total cigar sales of the defendant.

10 5. At the time of closing its plants the defendant had in stock leaf tobacco, manufactured stock and operating supplies valued at cost at the sum of \$7,355,811.21. During the year 1921 the price of tobacco steadily declined, and at the end of said year the market price of the stock then on hand did not exceed 60 per cent. of its cost value. The stock of tobacco had also seriously deteriorated in quality during the period when its factories were closed and for that reason was disposed of at a very heavy loss to the defendant.

20 6. The defendant sustained a loss in its operations during the year 1921 of \$2,704,394.92, which loss was occasioned by the causes above mentioned.

30 7. On December 31, 1920, the defendant had a floating indebtedness of \$3,050,000. Because of abnormal conditions in the money market the defendant was obliged in the spring of 1921 to fund this floating indebtedness. Accordingly, on May 15, 1921, the defendant issued its bonds in the amount of \$3,000,000., payable in ten years from said date, with interest at the rate of 8 per cent. per annum. These bonds were secured by a trust agreement which contained a sinking fund provision requiring the defendant to purchase and retire \$300,000. par value of such bonds in each year, if such bonds could be purchased at not over 105 and accrued interest. A copy of the trust agreement securing the said bonds is hereto annexed and marked "Schedule 1."

40 8. Although the defendant has been operating its factories since September 1, 1921, without serious labor troubles, it has not by any means recovered the position which it occupied during the year 1920 and previous years. During the year 1922 the total sales of its two

Affidavit of Thomas C. Breen.

leading brands of cigars amounted to only 55,000,000 as compared with sales of 113,000,000 of said brands in 1920, or in other words the sales of the cigars of said brands made in 1922 were but 49 per cent of the sales of the same brands in 1920.

9. While the business of the defendant improved materially during the last quarter of 1922, the operations for the entire year were conducted at a loss of \$390,238.41. 10

10. During the first three months of the current year the business of the defendant has been conducted at a profit of only \$3,205.27.

11. The defendant is now engaged in conducting an extensive advertising campaign, having made contracts for advertising during the months of June and July which will require an expenditure of approximately \$175,000. The purpose of such advertising campaign is to restore the brands of cigars manufactured by the defendant to popular favor. This will require an expenditure within the next six months of at least \$500,000. 20

12. For the three years up to and including 1920 the average investment at the close of each year in leaf tobacco, raw materials and manufactured stock was \$5,968,398.61. On December 31, 1921, such investment was \$5,115,903.69; on December 31, 1922, \$4,057,866.75, and on March 31, 1923, only \$3,893,790.77. At the end of the year 1918 the defendant had in stock tobacco of the 1918 Porto Rican crop of the cost value of \$1,932,680.20, which represented the normal amount that the defendant had been accustomed to carry for the purposes of its business. On December 31, 1922, the defendant had in stock tobacco of the Porto Rican crop of said year of the cost value of only \$762,265.42. This quantity of tobacco was less than one-half of the requirements of the defendant for the normal sale of its products. The defendant however was unable to make more extensive purchases of tobacco of said crop because of lack of working capital. 30 40

Affidavit of Thomas C. Breen.

10 13. Because of the relatively small amount of tobacco carried in stock of the 1922 crop the defendant will be required to make much larger purchases of tobacco in the market during the current year than were made during the preceding year. This it has not been able to do because of lack of working capital. In order to make the required purchases of tobacco in the market the defendant should have available for the purpose at least the sum of \$1,000,000 additional capital.

20 14. The only practicable method available for the defendant to secure the \$1,500,000. additional capital (\$500,000. for advertising and \$1,000,000. for tobacco purchases) which it must have in order to successfully transact its business is by the sale of additional capital stock. Section 24 of the trust agreement above mentioned limits the defendant's borrowing power by providing that so long as any of the bonds secured thereby remain outstanding and unpaid, the defendant will at all times maintain current assets as defined in Section 50 of said trust agreement at an aggregate amount equal to at least 1.75 per cent of all liabilities, including the aggregate principal amount of such outstanding bonds. On March 31, 1923, the ratio of current assets of the defendant to all liabilities was 1.85 to 1.00. An increase of liabilities of the defendant by \$250,000. without an increase of assets would place the defendant in default under this provision.

30 15. Because of this provision and because of the high interest payable on its outstanding bonds, the defendant has from time to time purchased more of said bonds than was required by the sinking fund provisions of said trust agreement. By so doing it has reduced its liabilities and decreased the amount of current assets necessary to be maintained at the ratio of 1.75 of current assets to 1.00 of liabilities under Section 24 of said trust agreement.

40 16. Although the defendant has an authorized capital stock of \$10,000,000. divided into 100,000 shares of the

Affidavit of Thomas C. Breen.

par value of \$100. each, of which but 62,816½ shares have been issued, it is practically impossible for the defendant to secure additional capital by selling additional shares of its present authorized capital stock as such shares cannot lawfully be sold for less than par. Said stock is listed on the New York Stock Exchange and has sold during the previous twelve months at prices ranging from \$47. to \$96. per share, the sales at \$96. having occurred in the latter part of March after the announcement of the plan embodied in the resolution adopted by the Board of Directors on March 13, 1923, providing for the conversion of the present stock into preferred stock and the issuing of non-par common stock. After the abandonment of said plan had been announced the stock dropped to \$78. per share. In view of the circumstances above detailed the only practicable method by which the defendant can raise the necessary capital is by the issuance of non-par stock.

17. The allegation contained in the respective bills of complaint that on December 31, 1922, the defendant had liabilities of only \$1,038,880, is incorrect, because it omits the bonded indebtedness of the defendant which at the time amounted to \$2,385,500. The ratio of current assets to liabilities on said date, as shown in the consolidated balance sheet of the defendant and its affiliated companies was not 6.50 to 1.00, as stated in paragraph 12 of the bill of complaint filed by said Philip M. Grausman and in paragraph 18 of the bill filed by William Rice Hochster and others, but 1.92 to 1.00. If the liabilities of the defendant had been but \$350,000. greater at that time it would have been in default under Section 24 of said trust agreement.

18. It has always been the custom of the defendant to carry its real estate, machinery and fixtures on its books at cost and to enter on said books as a liability the accrued depreciation of such property instead of writing off at the end of each year the annual depreciation.

Affidavit of Thomas C. Breen.

The consolidated balance sheets issued by the defendant at the end of each year show the real estate, machinery, fixtures, etc., at cost without deduction for depreciation, and the accrued depreciation appears on said statement as a liability under the caption "Reserved for Depreciation." Pursuant to such custom such item has been built

10 up annually by adding thereto the actual depreciation for each year. The amount of depreciation of said property which had accrued up to and including December 31, 1922, was \$718,291.94 as appears from the consolidated balance sheet of said defendant and its affiliated companies dated December 31, 1922, copy of which is hereto annexed and marked Schedule 2. The amount of depreciation of such property, which had accrued up to and including December

20 31, 1921, was \$659,352.16, as appears from the consolidated balance sheet of the defendant and its affiliated companies bearing date December 31, 1921, copy of which is hereto annexed and marked "Schedule 5." The amount of depreciation of such property which had accrued up to and including December 31, 1920, was \$593,206.87, this sum being included with other items making up the sum of \$726,324.80 shown as the item "Reserve Funds" on the consolidated balance sheet of the defendant and its affiliated companies dated December 31, 1920, copy of which is hereto annexed and marked "Schedule 6."

THOMAS C. BREEN.

30 Sworn to and subscribed before me
this 20th day of June, 1923.

ANNA C. TILLER,

(SEAL)

Notary Public, Bronx County.

Bronx County Clerk's Number 13,

Bronx Register's Number 29.

Certificate filed in New York County.

Clerk's Number 59; Register's Number 5070.

Commission Expires March 30, 1925.

40

County Clerk's Certificate attached.

Affidavit of Ambrose H. Burroughs.

STATE OF NEW YORK, }
COUNTY OF NEW YORK. } ss.

AMBROSE H. BURROUGHS, being duly sworn according to law, on his oath says:

1. I reside at Irvington-on-Hudson, New York, and am engaged in business at No. 200 Fifth Avenue, New York City. 10

2. I am a director of Porto Rican-American Tobacco Company, the defendant in the above-entitled actions, and have continuously held such office for a number of years.

3. I was present at the meeting of the Board of Directors held on May 3, 1923, when the resolution was adopted providing for the increase of the capital stock of the defendant, and voted in favor of said resolution. In doing so, I was influenced solely and entirely by what I considered to be for the best interest of the defendant and its stockholders. I was familiar with the financial condition of the defendant and considered that the plan set forth in said resolution was the only feasible plan available to the defendant for raising the necessary additional capital. I was not influenced by any ulterior motive whatever in voting for said resolution, and no person or group of persons made any attempt to influence me in any way whatsoever in connection therewith. I know of no group of persons consisting of defendant's directors or any of them who are co-operating with any person or group of persons interested in Tobacco Products Corporation, or any of its affiliated companies, for the purpose of securing a stock interest in defendant for said Tobacco Products Corporation, or any of its affiliated companies or stockholders and do not believe that any such group exists. 20 30

4. The previous plan set forth in resolution of the Board of Directors adopted March 13, 1923, was finally and definitely abandoned on April 30, 1923, at which time 40

Affidavit of Ambrose H. Burroughs.

10 said resolution of March 13, 1923, was cancelled and the contract made between Tobacco Products Corporation and defendant company for the sale of the defendant's stock to Tobacco Products Corporation was ended and cancelled. No other contract has been made, and no understanding or arrangement of any kind or character whatsoever exists for the acquisition by Tobacco Products Corporation, or any of its affiliated companies, of any stock interest in the defendant, and there are no pending negotiations to that end.

20 5. My knowledge of the affairs and financial condition of the defendant justify me in stating that I am convinced that the business of the defendant and the interest of its stockholders therein will be jeopardized unless the defendant shall be able to secure a large amount of additional capital within the near future, and I know of no practicable way of accomplishing this purpose except that provided for in said resolution adopted May 3, 1923.

A. H. BURROUGHS.

Sworn to and subscribed before me this
20th day of June, 1923.

ANNA C. TILLER,
(SEAL)

30 Notary Public, Bronx County.
Bronx County Clerk's No. 13,
Bronx Register's No. 29.
Certificate filed in New York County,
Clerk's No. 59. Register's No. 5070.
Commission expires March 30, 1925.
County Clerk's certificate attached.

Affidavit of Frederick L. Kenney.

STATE OF NEW YORK, }
 COUNTY OF NEW YORK. } ss.

FREDERICK L. KENNEY, being duly sworn according to law, on his oath says:

1. I reside in the City, County and State of New York and am second Vice-President and a Director of Porto Rican-American Tobacco Company, the defendant in the above-entitled actions. 10

2. I am familiar with the condition of the business of defendant company and its financial situation. I have read the affidavits of Luis Toro, Thomas C. Breen and Harry Catlin hereto annexed. The matters of fact contained in said affidavits are true.

3. I attended the meeting of the Board of Directors held on May 3, 1923, at which the resolution providing for the amendment of the certificate of incorporation of the defendant, so as to provide for the issuance of Class B non-par, common stock, was adopted. I voted in favor of said resolution, which was unanimously passed at said meeting. I had no object whatever in voting for said resolution, except to provide a fair and practicable method for raising the additional capital which the defendant must have if it is to regain its former position as a manufacturer of cigars. No stockholder or group of stockholders of the defendant, nor any one connected with Tobacco Products Corporation, or any of the companies owned or controlled by it, or with any other outside interest, influenced me or attempted so to do with reference to said resolution, or, in fact, with reference to any other business of the defendant. I represent no special interest on the Board of Directors, and in voting for said resolution I acted solely in the interest of the defendant and not in the interest of any particular stockholder or group of stockholders, or any other person, or other corporation whatsoever. 20 30 40

Affidavit of Frederick L. Kenney.

4. I am convinced from my knowledge of the affairs of the defendant and my acquaintance with the members of the Board of Directors and from what has transpired at the meetings of the Board, and particularly at said meeting of May 3, 1923, that the resolution was passed solely in the interest of the stockholders generally for the purpose of providing sufficient additional capital to enable the defendant to successfully prosecute its business. I am also convinced that the interests of the stockholders will be jeopardized if the defendant shall fail in procuring the necessary additional capital.

5. The plan that was originally adopted as embodied in the resolution of March 13, 1923, was finally and definitely abandoned on April 30, 1923. No contract has been made and no arrangement or understanding of any kind or character exists which contemplates the sale of any of the stock of defendant company to Tobacco Products Corporation, or any of the corporations owned or controlled by it, or to any person or corporation except *pro rata* to the defendant's existing stockholders. I am convinced that no negotiations concerning any such arrangement are pending.

FREDERICK L. KENNEY.

Sworn to and subscribed before me this
20th day of June, 1923.

JAS. H. FORD,
(SEAL)

Notary Public, Westchester County.

Certificate filed in New York County No. 144.

New York Register's Number 4159,

My commission expires March 30, 1924.

County Clerk's certificate attached.

Affidavit of James M. Dixon.

STATE OF NEW YORK, }
 COUNTY OF NEW YORK. } ss.

JAMES M. DIXON, of full age, being duly sworn according to law, on his oath says:

I am the same person who for and on behalf of the Tobacco Products Corporation executed the contract between that Company and the Porto Rican American Tobacco Company, dated the 12th of March, 1923, the same being in the form of a letter addressed to the Porto Rican American Tobacco Company and the acceptance, subject to certain contingencies, of the Porto Rican American Tobacco Company appearing at the foot of the letter, the said contract providing for the purchase by the Tobacco Products Corporation of certain stock of the Porto Rican American Tobacco Company. I was at that time and am still President of the Tobacco Products Corporation.

I was advised that the Porto Rican American Tobacco Company was restrained from holding the necessary special meeting of stockholders for the passage of the resolution referred to in said contract. The acquisition of the stock by the Tobacco Products Corporation was contingent upon the passage of the resolution which was made a part of the contract. I was further advised that the Porto Rican American Tobacco Company thereupon cancelled the resolution calling the meeting of stockholders for the amendment of its charter and definitely abandoned the plan therein set forth. The contract between the two companies thereupon terminated.

There has been no other contract made looking to the Tobacco Products Corporation acquiring stock of the Porto Rican American Tobacco Company and there are no pending negotiations looking to that end.

I know of no group of persons who dominate the two companies and do not believe that any such exist.

I have been advised by counsel of Porto Rican American Tobacco Company that the following parties constituted

Affidavit of James M. Dixon.

the Board of Directors of Porto Rican American Tobacco Company on May 3, 1923:

Luis Toro
 John Frese
 N. Pasarell
 A. H. Noble
 F. L. Kenney
 H. L. Brown
 A. H. Burroughs
 R. M. Byrnes
 H. Catlin
 H. D. Newton

10

and that not long thereafter H. D. Newton resigned as director and T. C. Breen was elected in his place.

None of the aforesaid parties held any stock of record on May 3, 1923, of Tobacco Products Corporation, except Luis Toro, who held 441 shares of Class A stock in said company, and so far as I am informed or believe none of them owned any stock in any of the companies owned or controlled by Tobacco Products Corporation, or any stock in United Retail Stores Corporation, or United Cigar Stores Company of America, except I have been informed and believe that Luis Toro owned 200 shares of preferred stock of United Cigar Stores Company of America, which he had owned for more than ten years.

I make this affidavit solely at the request of counsel of the Porto Rican American Tobacco Company.

30

JAMES M. DIXON.

Sworn to and subscribed before me this
 21st day of June, 1923.

ALICE MAYER,

(SEAL)

Notary Public, Bronx County No. 24.

Certificate filed in New York County No. 152,

My commission expires March 30, 1924.

County Clerk's certificate attached.

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*Schedule 1.***Schedule 1.**

PORTO RICAN AMERICAN TOBACCO COMPANY

WITH

THE NATIONAL CITY BANK OF NEW YORK,

AS TRUSTEE

10

TRUST AGREEMENT

Dated May 15, 1921.

Securing

\$3,000,000 Ten Year Eight Per Cent. Gold Bonds

AGREEMENT, this 15th day of May, 1921, between the PORTO RICAN AMERICAN TOBACCO COMPANY, a corporation organized and existing under the laws of the State of New Jersey (hereinafter called the "Company"), party of the first part, and THE NATIONAL CITY BANK OF NEW YORK, a corporation organized and existing under the laws of the United States of America (hereinafter called the "Trustee"), party of the second part.

20

WHEREAS, the Company has deemed it necessary to borrow money for its corporate purposes and, to that end, has duly authorized and directed an issue of bonds, not exceeding the aggregate principal amount of Three Million Dollars, to be designated as its Ten Year Eight Per Cent. Gold Bonds, to be dated as of May 15, 1921, to mature May 15, 1931, to be secured by the pledge of the property hereinafter described, to bear interest from date at the rate of eight per cent. per annum, payable semi-annually on November 15 and May 15 in each year, to be signed in its corporate name by its President or a Vice-President, impressed with its corporate seal, attested by its Secretary or an Assistant Secretary, to have interest coupons attached, executed with the facsimile signature of its Treasurer, and to be authenticated by the certificate of the Trustee indorsed thereon, which Bonds, interest

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Schedule 1.

coupons and Trustee's certificate are to be substantially in the following forms, respectively (except that the words "unless the Bond herein mentioned shall have been called for previous redemption," shall be omitted from all interest coupons maturing November 15, 1921):

10

[FORM OF BOND]

No.

\$

UNITED STATES OF AMERICA

PORTO RICAN AMERICAN TOBACCO COMPANY

TEN YEAR EIGHT PER CENT. GOLD BOND

20

PORTO RICAN AMERICAN TOBACCO COMPANY (hereinafter called the "Company"), for value received, promises to pay to Bearer, or if the ownership of this Bond be registered, to the registered holder, hereof, the principal sum of

Dollars, on May 15, 1931,

30

and to pay interest thereon from the date hereof, at the rate of eight per cent. per annum, semi-annually on November 15 and May 15 in each year. Until the maturity of this Bond, such interest shall be paid only upon the presentation and surrender of the attached interest coupons as they severally mature. Both principal and interest of this Bond are payable in United States gold coin of or equal to the present standard of weight and fineness, at the principal office of the Trustee hereinafter named, in the Borough of Manhattan, City and State of New York.

40

The Company will, in each year, refund and repay to the holder of this Bond the amount of any lawful tax thereon paid by him in and for such year to the Commonwealth of Pennsylvania, not exceeding 4/10ths of one per cent. of the principal amount hereof, upon presentation to the Company of receipts, or other evidence satisfactory to it, of the payment of such tax, within four months after the payment thereof.

Schedule 1.

This is one of a duly authorized issue of Bonds of the Company, of an aggregate principal amount of not exceeding Three Million Dollars, known as its Ten Year Eight Per Cent. Gold Bonds, all of like date and substantially similar tenor, except as to the denomination thereof, and all issued under and equally secured by a certain Trust Agreement, dated May 15, 1921, executed between the Company and The National City Bank of New York, as Trustee, to which Trust Agreement reference is hereby made for a statement of the terms under which the said Bonds are issued, the nature of the security and the rights and obligations of the Company, the Trustee and the respective holders of the said Bonds with respect thereto.

10

In the event of default by the Company as set forth in the said Trust Agreement, the principal of all the Bonds issued and outstanding thereunder may be declared or may become due and payable before maturity in the manner and with the effect therein provided.

20

This Bond, together with all other outstanding Bonds of this issue, may be redeemed as a whole, but not as to a part only thereof, on any semi-annual interest date prior to maturity, upon at least thirty days' prior published notice, and in the manner provided in the said Trust Agreement, at 107½ per cent. of the principal amount thereof, if redeemed on or before May 15, 1926, and at 105 per cent. thereof, if redeemed thereafter.

30

This Bond shall pass by delivery until registered in the owner's name on books kept for that purpose at the said principal office of the Trustee, such registration being noted hereon. After such registration, no further transfer hereof shall be valid unless made on the said books by the registered holder in person or by duly authorized attorney, and similarly noted hereon; but this Bond may be discharged from registry by being in like manner transferred to bearer, and thereupon transferability by delivery shall be restored. This Bond shall continue to

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Schedule 1.

be subject to successive registrations and transfers to bearer, at the option of the holder; but no registration shall affect the negotiability of the attached interest coupons, which shall continue to be payable to bearer and transferable by delivery merely.

- 10 No recourse shall be had for the payment of any part of either principal or interest of this Bond, or for any claim based hereon or thereon, or otherwise in any manner in respect hereof or in respect of the said Trust Agreement, to or against any stockholder, officer or director of the Company, past, present or future, by virtue of any statute or by the enforcement of any assessment or penalty or in any manner.

This Bond shall not be obligatory or valid for any purpose until authenticated by the execution by the Trustee of the certificate indorsed hereon.

- 20 IN WITNESS WHEREOF, the Company has caused this Bond to be executed in its corporate name by its President or a Vice-President and impressed with its corporate seal, attested by its Secretary or an Assistant Secretary, and the attached interest coupons to be executed with the facsimile signature of its Treasurer, as of May 15, 1921.

PORTO RICAN AMERICAN TOBACCO COMPANY,

By

President

30

Attest:

Secretary

40

Schedule 1.

[FORM OF INTEREST COUPON]

No.

\$

On the 15th day of _____, 19____, unless
 the Bond herein mentioned shall have been called for
 previous redemption, PORTO RICAN AMERICAN TOBACCO
 COMPANY will pay to Bearer, at the principal office of The
 National City Bank of New York, in the Borough of
 Manhattan, City and State of New York, 10

Dollars, in United States gold coin, being six
 months' interest then due on its Ten Year Eight Per Cent.
 Gold Bond, No.

Treasurer

[FORM OF TRUSTEE'S CERTIFICATE]

This in one of the Bonds described in the within men- 20
 tioned Trust Agreement.

THE NATIONAL CITY BANK OF NEW YORK,
 as Trustee,

By

AND WHEREAS all things necessary to make the Bonds,
 when duly authenticated by the Trustee, the valid, bind-
 ing and legal obligations of the Company, and to consti- 30
 tute this Agreement a valid instrument for the security
 thereof, have been done and performed, and the execution
 and delivery of this Agreement and the issue of the Bonds,
 as in this Agreement provided, have been in all respects
 duly authorized;

NOW, THEREFORE, THIS AGREEMENT WITNESSETH:
 That, in consideration of the premises and of the pur-
 chase and acceptance of the Bonds by those who shall
 hold the same from time to time, and of the sum of One
 Dollar to the Company duly paid by the Trustee, the 40

Schedule 1.

reecipt whereof is hereby acknowledged, and to secure the payment of the principal and interest of all the Bonds at any time issued and outstanding hereunder, according to their tenor and effect, and to secure the faithful observance and performance of all the covenants and conditions herein contained, the Company has
 10 assigned, conveyed, pledged, transferred and set over, and, by these presents, does assign, convey, pledge, transfer and set over unto the Trustee, its successors and assigns, forever, ALL AND SINGULAR the following described shares of stock now owned by the Company (which, together with any other securities which may at any time be held by the Trustee hereunder, are hereinafter sometimes referred to, collectively, as the "pledged property"):

20 68,608 shares, of the par value of \$100 each, of the capital stock of the Porto Rican American Tobacco Company of Porto Rico, a corporation organized and existing under the laws of Porto Rico, comprising all of the outstanding capital stock thereof.

2,500 shares, of the par value of \$100 each, of the capital stock of the Porto Rican Leaf Tobacco Company, a corporation organized and existing under the laws of the State of New Jersey, comprising fifty per cent. of the outstanding capital stock thereof.

30 IN TRUST, NEVERTHELESS, upon the terms and conditions herein set forth, for those who shall hold the Bonds issued hereunder and the interest coupons pertaining thereto, without preference of any of the Bonds or interest coupons over any of the others by reason of priority in the time of issue, sale or negotiation thereof, or otherwise for any cause whatever;

40 PROVIDED, HOWEVER, and these presents are upon the express condition, that, if the Company, its successors or assigns, shall well and truly pay, or cause or secure to be paid, the principal of the Bonds and the interest due or

Schedule 1.

to become due thereon, at the times and in the manner mentioned in the Bonds, according to the true intent and meaning thereof, and shall well and truly keep, perform and observe all the covenants and conditions in this Agreement expressed to be kept, performed and observed by it, and shall pay to the Trustee all sums of money due or to become due to it in accordance with the terms and provisions hereof, then this Agreement and the rights hereby granted shall cease, determine and be void, and the Trustee, in such case, on written demand of the Company, shall cancel and satisfy this Agreement and shall deliver to or upon the written order of the Company, signed by its President or a Vice-President and its Secretary or an Assistant Secretary, the pledged property then in its possession; otherwise to be and remain in full force and effect. 10

AND IT IS HEREBY COVENANTED AND AGREED, that the Bonds are to be issued, authenticated and delivered, and the pledged property is to be held by the Trustee, subject to the following covenants, conditions, uses and trusts: 20

ARTICLE FIRST

DESIGNATION, FORM, ISSUE, AUTHENTICATION AND REGISTRATION OF BONDS

SECTION 1. The Bonds to be issued under this Agreement shall be designated as the Company's "Ten Year Eight Per Cent. Gold Bonds", and they and the interest coupons attached thereto shall be substantially in the form and of the tenor hereinbefore recited, respectively. Bonds may be issued, at the option of the Company, in denominations of either \$1000 or \$500. 30

SECTION 2. Upon the execution hereof, the Company shall execute in the manner hereinbefore recited and deliver to the Trustee, Three Million Dollars, aggregate principal amount, of Bonds; and the Trustee shall thereupon authenticate the same and deliver the Bonds so 40

Schedule 1.

authenticated to or upon the written order of the Company, signed by its President or a Vice-President. The Trustee shall be under no obligation to see to the proper application of the Bonds, or of the proceeds thereof, by the Company.

10 Only such bonds as shall be authenticated by a certificate substantially in the form hereinbefore recited, executed by the Trustee, shall be entitled to any right or benefit under this Agreement; and such authentication by the Trustee shall be conclusive evidence that any Bond so authenticated has been duly issued hereunder and that the holder is entitled to the benefits hereof.

20 SECTION 3. Definitive Bonds of the denomination of \$500 shall be exchangeable, at the option of the holder, for a like aggregate principal amount of definitive Bonds of the denomination of \$1000; and each definitive Bond of the denomination of \$500 shall bear indorsed thereon such appropriate legend in reference to the privilege of such exchange as may be necessary or advisable, to comply with the rules of any stock exchange or to conform with usage in respect thereto. Whenever definitive Bonds of the denomination of \$500 in principal amounts aggregating One Thousand Dollars, or some multiple thereof, with all unmatured interest coupons attached, shall be surrendered to the Trustee for such purpose, the Company shall execute and thereupon the Trustee shall
30 authenticate and deliver in exchange therefore an equal aggregate principal amount of definitive Bonds of the denomination of \$1000. For any such exchange the Company, at its option, may require the payment of a sum sufficient to reimburse it for any governmental charge connected therewith or resulting therefrom, and also a further sum, not exceeding Two Dollars for each new Bond issued upon such exchange. In case of any such exchange, the Trustee shall forthwith cancel the surrendered Bonds and interest coupons, and shall deliver the
40 same to the Company on its written request therefor.

Schedule 1.

SECTION 4. The holder of any definitive Bond may have the ownership thereof registered on books to be kept for that purpose at the principal office of the Trustee in the Borough of Manhattan, City and State of New York, and such registration noted on the Bond. After such registration, no further transfer of such Bond shall be valid unless made on the said books by the registered holder in person or by duly authorized attorney and similarly noted on the Bond; but the same may be discharged from registry by being in like manner transferred to bearer, and thereupon transferability by delivery shall be restored. Bonds shall continue to be subject to successive registrations and transfers to bearer, at the option of their respective holders; but no registration of any Bond shall affect the negotiability of the interest coupons pertaining thereto, which shall continue to be payable to bearer and transferable by delivery merely.

SECTION 5. Until definitive Bonds are prepared, the Company may execute and deliver typewritten or printed temporary Bonds, substantially of the tenor of the Bonds hereinbefore recited, except that such temporary Bonds shall be issued without interest coupons and shall not contain provisions for registration. Such temporary Bonds shall be of the denominations of \$500, \$1000 or any multiple thereof, as the Company may determine, and shall bear upon their face the words, "Temporary Bond: exchangeable for a like principal amount of definitive Bonds", and shall be authenticated by the Trustee in substantially the same manner as is herein provided for the definitive Bonds, and such authentication shall be conclusive evidence that any temporary Bonds so authenticated has been duly issued hereunder, and that the holder is entitled to the benefits of this Agreement. Any or all such temporary Bonds duly issued and authenticated hereunder shall be exchangeable for a like principal amount of definitive Bonds, when such definitive Bonds are ready for delivery, and upon any such ex-

Schedule 1.

change, the temporary Bonds shall forthwith be cancelled by the Trustee and, upon demand, delivered to the Company. Until so exchanged, such temporary Bonds shall in all respects be entitled to the benefits of this Agreement, as Bonds issued and authenticated hereunder; and interest, when and as paid, shall be indorsed thereon.

- 10 SECTION 6. In case any Bond issued hereunder, with its interest coupons, if any, shall be mutilated, destroyed or lost, the Company in its discretion may issue, and thereupon the Trustee shall authenticate and deliver, a new Bond of like denomination, tenor and date, in exchange and substitution for and upon the cancellation of the mutilated Bond and its interest coupons, or in lieu of and in substitution for the Bond and its interest coupons so destroyed or lost, upon receipt of evidence satisfactory to the Company and the Trustee of the destruction or loss of such Bonds and its interest coupons and
20 upon the receipt, also, of indemnity satisfactory to them.

ARTICLE SECOND

COVENANTS OF THE COMPANY

The Company covenants with the Trustee and with the holders of the Bonds as follows:

- 30 SECTION 7. The Company will pay the principal and interest of all the Bonds duly issued hereunder according to the terms thereof and of this Agreement.

- SECTION 8. The Company will, in each year, refund and repay to the holder of any Bond or Bonds issued hereunder the amount of any lawful tax thereon paid by him in and for such year, to the Commonwealth of Pennsylvania, not exceeding $\frac{4}{10}$ ths of one per cent. of the principal amount thereof, upon presentation to the Company of receipts, or other evidence satisfactory to it, of the payment of such tax, within four months after the payment thereof.
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SECTION 9. The Company will at all times, until the payment of all the Bonds issued hereunder, keep an office or agency in the Borough of Manhattan, City and State of New York, where notices and demands in respect of such Bonds may be served; and it will, from time to time, give notice to the Trustee of the location of such office or agency. In case the Company shall fail so to do, notices may be served and demands may be made at the principal office of the Trustee, in the said Borough of Manhattan, City of New York. The Company will at all times keep or cause to be kept at the said principal office of the Trustee, books in which the ownership of any of the definitive Bonds may be registered, upon presentation thereof for such purpose, as provided in Section 4 hereof. 10

SECTION 10. So long as any of the Bonds remain outstanding and unpaid, the Company will not directly or indirectly extend or assent to the extension of the time for the payment of any interest coupon or claim for interest of or upon any Bond, and it will not directly or indirectly be a party to any arrangement therefor, either by purchasing or refunding or in any manner keeping alive such interest coupon or claim for interest, or otherwise. In case the payment of any such interest coupon or claim for interest shall be so extended by or with or without the consent of the Company, then, anything in this Agreement contained to the contrary notwithstanding, such interest coupon or claim for interest so extended shall not be entitled, in case of default hereunder, to any benefit of or under this Agreement, except after the prior payment in full of the principal of all the Bonds issued hereunder and of all such interest coupons and claims for interest as shall not have been so extended. 20 30

SECTION 11. The Company is lawfully possessed of all the shares of stock hereby pledged, and has good right to pledge the same for the purposes herein expressed. 40

Schedule 1.

SECTION 12. At the date of the execution of this Agreement, the Company owns or controls, free and clear of any pledge or lien or adverse claim whatever, the following issued and outstanding shares of the capital stock of the following named corporations:

10 68,608 shares, of the par value of \$100 each, of the capital stock of the Porto Rican American Tobacco Company of Porto Rico, a corporation organized and existing under the laws of Porto Rico, comprising all the outstanding capital stock thereof.

2,500 shares, of the par value of \$100 each, of the capital stock of the Porto Rican Leaf Tobacco Company, a corporation organized and existing under the laws of the State of New Jersey, comprising fifty per cent. of the outstanding capital stock thereof.

20 500 shares, of the par value of \$100 each, of the capital stock of the Industrial Company of Porto Rico, a corporation organized and existing under the laws of the State of Delaware, comprising all the outstanding capital stock thereof.

500 shares, of the par value of \$100 each, of the capital stock of M. Alvarez & Company, a corporation organized and existing under the laws of the State of Delaware, comprising all the outstanding capital stock thereof.

30 The term "constituent company", as used in this Agreement, shall mean each of the above corporations and any other corporation, all the shares of the outstanding capital stock of which, except directors' qualifying shares, shall now or hereafter be owned by the Company.

SECTION 13. The Company has heretofore caused the New York-Tampa Cigar Company (hereinafter referred to as the "new company") to be incorporated under the laws of the State of Delaware, with an authorized capital stock of \$500,000, par value, of preferred stock, and 15,000 shares of common stock, without nominal or par value, and proposes to cause the said M. Alvarez & Com-

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Schedule 1.

pany and the said Industrial Company of Porto Rico (hereinafter referred to collectively as the "old companies") to transfer and convey their respective businesses and all their properties, assets and franchises to the new company; whereupon, the said old companies will be dissolved. The Company covenants that it will acquire all the issued and outstanding preferred stock of the new company, of an aggregate par value at least equal to the aggregate amount of the net tangible assets of the old companies, so conveyed, and at least sixty per cent. of the issued and outstanding common stock of the new company; and the new company shall thereafter be considered a constituent company within the meaning of this Agreement and all the provisions of this Agreement relating to constituent companies shall apply equally to the new company. 10

SECTION 14. So long as any of the Bonds remain outstanding and unpaid, the Company will from time to time acquire, free from any pledge or lien, as issued, such proportion of any additional stock which may be issued by any of its constituent companies, as the amount owned or controlled by the Company immediately prior to such issue bore to the total amount of the capital stock of such constituent company then issued and outstanding. 20

SECTION 15. So long as any of the Bonds remain outstanding and unpaid, if at any time either the said Porto Rican American Tobacco Company of Porto Rico or the said Porto Rican Leaf Tobacco Company, or any successor or assign of either of them, shall increase its issued capital stock, the Company will forthwith cause to be deposited and pledged with the Trustee the same proportion of such increased capital stock as immediately prior to such increase the stock of such constituent company then pledged hereunder, bore to the total amount of the capital stock of such constituent company, then issued and outstanding. 30 40

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SECTION 16. So long as any of the Bonds remain outstanding and unpaid, the Company will comply, and will cause each constituent company to comply, with all lawful requirements of the laws of the State of New Jersey, of the Island of Porto Rico and of any other State or States of the United States of America or of any other government, applicable to the Company or to any constituent company; and it will not do, suffer or permit any act or thing whereby the payment of the indebtedness evidenced by the Bonds issued hereunder might or could be hindered, delayed or imperilled, or whereby the security of the same might or could be impaired or injuriously affected.

SECTION 17. So long as any of the Bonds remain outstanding and unpaid, the Company will not execute any mortgage upon, or make any pledge of, any part of its fixed assets (as defined in Section 50 hereof) or guarantee any part of the funded indebtedness of any constituent or other company, and it will not either directly or indirectly make, issue or negotiate any other issue of bonds, notes or other funded obligations, or contract any funded indebtedness, without expressly providing as part of the terms thereof, that all such bonds, notes or other funded obligations or indebtedness shall be subject and subordinate to the Bonds issued under this Agreement, and that, until all the Bonds issued hereunder shall have been paid in full, none of such other bonds, notes, funded obligations or indebtedness shall be payable or paid, and that the payment of the same shall be unconditionally postponed, and that the holders thereof shall have no right in law or in equity to sue for or enforce the payment thereof, by suit or otherwise; *provided*, that nothing herein shall apply to such notes, debts, obligations, liabilities or contracts as may be made, incurred or contracted by the Company in the ordinary course of conducting its business, and maturing not later than one year from their date.

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SECTION 18. The properties and assets of each of the Company's constituent companies are free of any mortgage or lien of any character. So long as any of the Bonds remain outstanding and unpaid, the Company will at no time suffer or permit any constituent company to execute any mortgage upon, or make any pledge of, any part of its fixed assets, or to make, issue or negotiate any bonds, notes or other funded obligations; *provided*, that nothing herein shall apply to such notes, debts, obligations, liabilities or contracts as may be made, incurred or contracted by any constituent company in the ordinary course of conducting its business and maturing not later than one year from their date; and *provided*, further, that nothing herein contained shall prevent a constituent company from acquiring property subject to an existing mortgage or mortgages thereon, if the liability assumed by such constituent company with respect to the aggregate indebtedness secured by such mortgage or mortgages shall not exceed sixty per cent. of the fair physical value of such property, or from securing the purchase price of property hereafter acquired by a purchase money mortgage or mortgages of not exceeding in the aggregate a like percentage of its fair physical value.

SECTION 19. So long as any of the Bonds remain outstanding and unpaid, the Company (except as in this Agreement otherwise expressly provided or permitted) will not sell or otherwise dispose of any shares of stock of any constituent company now owned or hereafter acquired.

SECTION 20. So long as any of the Bonds remain outstanding and unpaid, the Company will not consolidate with any corporation other than a constituent company, and will not merge or permit itself to be merged into any corporation, including any constituent company, unless prior to such consolidation or merger all of the Bonds issued and outstanding hereunder shall be redeemed and paid.

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SECTION 21. So long as any of the Bonds remain outstanding and unpaid, the Company will not lease any substantial or essential part of its fixed assets, and it will not suffer or permit any constituent company to lease any substantial or essential part of the fixed assets of such constituent company, except for a fair and reasonable consideration and with the approval of the Trustee.

10 In case the Company or any constituent company shall desire to lease any substantial or essential part of its fixed assets, the Company shall furnish to the Trustee (1) a copy of the proposed lease, certified by its Secretary or Assistant Secretary, setting forth the full consideration to be received therefor; (2) an appraisal made at the expense of the Company or of the constituent company proposing to execute such lease by a competent engineer chosen or approved by the Trustee, setting forth the actual replacement value of such fixed assets at the

20 time, and (3) a certificate signed by the President or a Vice-President of the Company and by its Treasurer or an Assistant Treasurer to the effect, either (a) that no part of such fixed assets are needed for use in or in connection with the business of the company proposing to execute the lease, or (b) that such company has made provision for the acquisition or use of other fixed assets or facilities of a similar character and at least equal in essential value to the fixed assets so to be leased and that the business of

30 the company will not be injuriously affected by such lease. If, from an examination of the said instruments, the Trustee, in its discretion, shall be satisfied that the consideration to be paid under the proposed lease is a fair one and that there is no reasonable objection thereto, the Trustee shall approve the lease and thereupon, and not otherwise, such company may execute and deliver the same. The Trustee shall not be responsible to the Company or to any constituent company or to the holder of

Schedule 1.

any Bond or Bonds for the giving or the withholding of its approval of any lease, as herein provided.

Without in any way limiting the meaning of the term "substantial or essential part of its fixed assets" as used in this Section 21, the said term shall include in all cases any fixed assets of a book value in excess of the sum of \$50,000.

SECTION 22. Except as in this Agreement otherwise expressly provided, in case the Company or any constituent company shall sell any substantial or essential part of its fixed assets, the Company will cause the proceeds of such sale to be applied to the acquisition of other fixed assets for the company making such sale at least equal in value to the fixed assets so sold, or, if not so applied within six months after the receipt thereof, the said proceeds or the unexpended balance thereof, or an amount in cash equivalent thereto, shall be paid over to the Trustee and applied by it, from time to time, as hereinafter provided in this Section 22; *provided, however*, that in case of the sale of fixed assets of a constituent company of which the Company shall not at the time be the owner of all the shares of the outstanding capital stock thereof, other than directors' qualifying shares, the Company shall not be obliged to pay over to the Trustee hereunder, at the expiration of the said period of six months, any greater sum than an amount in cash equivalent to such proportion of the then unexpended balance of the proceeds of any such sale as the stock of such constituent company then owned by the Company shall bear to the total amount of the outstanding capital stock thereof.

Without in any way limiting the meaning of the term, "Substantial or essential part of its fixed assets", as used in this Section 22, if in any calendar year fixed assets (whether of the Company or of any constituent company or companies) of a fair value of \$50,000 in the aggregate shall be sold, any fixed assets of any company thereafter sold during such year shall be considered to be included within the meaning of the said term.

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Any moneys paid over to the Trustee in pursuance of the provisions of this Section 22 shall be applied by it, from time to time, to reimburse the Company for expenditures made by it after the date of this Agreement in the acquisition of fixed assets (other than shares of stock), or in the purchase of Bonds of this issue at not more than
 10 105 per cent. of the principal amount thereof and accrued interest.

In case the Company shall at any time desire reimbursement for expenditures of the character above set forth, it shall deliver to the Trustee the following instruments:

(a) In case reimbursement is desired in respect to expenditures made by the Company in the acquisition of fixed assets (other than shares of stock), a certificate signed by the President and a Vice-President and the Treasurer or an Assistant Treasurer of the Company, verified by one of such officers, setting forth that the Company had made expenditures after the date of this Agreement in the purchase, construction or acquisition, as the case may be, of fixed assets which shall be therein described in reasonable detail, and certifying also, that such expenditures were not in excess of the reasonable fair value of such fixed assets; that no portion of such expenditures had been made or reimbursed out of the proceeds of any insurance or of any sale of fixed assets or of any Bonds issued hereunder; that the
 20 fixed assets so acquired are for use in or in connection with the business of the Company; that title thereto is vested in the Company, and that the Company is not in default in respect of any of the covenants or agreements contained in this Agreement on its part to be performed or observed.

(b) In case reimbursement is desired in respect to expenditures made by the Company in the purchase of Bonds of this issue, (1) a certificate signed by the President or a Vice-President and the Treasurer or an Assistant Treasurer of the Company, verified by one of such officers, setting forth that the
 30 Company had made expenditures in the purchase of
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Schedule 1.

Bonds issued hereunder, stating the amounts and serial numbers of the Bonds so purchased and the price paid therefor, respectively, which shall not be in excess of 105 per cent. of the principal amount thereof and accrued interest, and certifying, also, that such purchase price was not in excess of the market value of the said Bonds at the time of their purchase, respectively, or otherwise in excess of the sum necessary to purchase the same; that no portion of the expenditures so certified had been made or reimbursed out of the Sinking Fund provided for in Article Fifth hereof or out of the proceeds of any insurance or of any sale of fixed assets, and that the Company is not in default in respect of any of the covenants or agreements contained in this Agreement on its part to be performed or observed, and (2) the Bonds described in the said certificate, which shall forthwith be cancelled by the Trustee and re-delivered to the Company, upon its written request therefor; and no Bonds shall thereafter be issued in lieu thereof.

Upon the delivery to the Trustee of instruments of the character specified in either of the foregoing paragraphs (a) or (b), the Trustee, if satisfied therewith, shall, from the moneys then in its possession hereunder, pay out to or upon the written order of the Company, signed by its President or a Vice-President and its Treasurer or an Assistant Treasurer, an amount in cash equal to the expenditures so certified.

SECTION 23. Anything in this Agreement contained to the contrary notwithstanding the Company shall have the right at any time to cause or acquiesce in the dissolution of either the Porto Rican American Tobacco Company of Porto Rico or the Porto Rican Leaf Tobacco Company, or both of them.

I. Prior to the dissolution of the said Porto Rican American Tobacco Company of Porto Rico, the Company either (a) shall itself acquire all the properties and assets of such Company, or (b) shall cause all such properties

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to be conveyed to one or more constituent companies, or (c) shall itself acquire part of such properties and assets and cause the remainder thereof to be conveyed to one or more constituent companies.

10 II. Prior to the dissolution of the said Porto Rican Leaf Tobacco Company, the Company either (a) shall itself acquire at least one-half of the properties and assets of such Company, or (b) shall cause at least one-half of such properties and assets to be conveyed to one or more constituent companies or (c) shall itself acquire part of such properties and assets and shall cause the remainder thereof, to the extent of at least one-half of all such properties and assets, to be conveyed to one or more constituent companies.

20 III. No part of the properties or assets of either the Porto Rican American Tobacco Company of Porto Rico or the Porto Rican Leaf Tobacco Company shall be conveyed to any constituent company of which the Company shall not at the time be the owner of all the outstanding capital stock thereof, other than directors' qualifying shares; and immediately upon the acquisition of any such properties or assets by any such constituent company, the Company will cause all the outstanding capital stock thereof to be pledged with the Trustee hereunder.

30 SECTION 24. So long as any of the Bonds remain outstanding and unpaid, the Company will at all times maintain current assets (as defined in Section 50 hereof) at an aggregate amount equal to at least 175 per cent. of the aggregate amount of all liabilities, including the aggregate principal amount of the Bonds issued and outstanding hereunder, and will at all times maintain net current assets (as defined in Section 50 hereof) at an aggregate amount equal to at least 200 per cent. of the aggregate principal amount of such outstanding Bonds.

40 SECTION 25. So long as any of the Bonds remain outstanding and unpaid, the Company will not declare or

Schedule 1.

pay any cash dividends on its capital stock, except out of income earned subsequently to January 1, 1922; and in no event will it pay any cash or scrip dividend, if current assets amount to less than 200 per cent. of the aggregate amount of all liabilities, including the aggregate principal amount of the Bonds issued and outstanding hereunder, or if the payment of any such cash or scrip dividend would reduce current assets below such percentage of all liabilities. 10

SECTION 26. The Company and each of its constituent companies will at all times maintain, preserve and keep all its and their property, buildings, machinery, apparatus, equipment and fixtures in thorough repair and condition, and will, from time to time, make all needful and proper repairs thereto and replacements thereof, and will promptly pay and discharge, or cause to be paid and discharged, any and all lawful taxes, rates, levies, assessments, liens, claims or other charges whatever upon its and their respective properties, and every part thereof, and upon the income derived from its and their operations. 20

SECTION 27. The Company and each of its constituent companies will keep their respective buildings, apparatus, equipment, fixtures and stock of materials insured in good and responsible insurance companies against loss or damage, in such manner and to the same extent as has been usual in its business, and will furnish, or cause to be furnished, to the Trustee evidence to its satisfaction of all insurance, whenever so requested by it, and at least once in each year. 30

In case of loss or damage to any of the said properties, whereby the sum of \$5000 or more shall be collected or received under any policy or policies of insurance, all such insurance moneys, or an amount equivalent thereto, shall be applied either (a) in or toward the restoration of the property so lost or damaged, or (b) in or toward the 40

Schedule 1.

acquisition of other property for the use of the business of the company suffering such loss or damage, the title to which shall be vested in it, or (c) in or toward the construction of new buildings for such company, or (d) in or toward the purchase of new machinery, equipment, apparatus or fixtures, which shall be in addition to the
 10 plant of such company and not in substitution of old or worn out machinery, equipment, apparatus or fixtures, or (e), if not so applied within a period of six months after the collection or receipt thereof, the said moneys or the unexpended balance thereof, or an amount in cash equivalent thereto, shall be paid over to the Trustee to be applied by it in the manner hereinbefore provided in Section 22 hereof; *provided, however,* that in case of loss or damage to properties of a constituent company of which the Company shall not at the time be the owner of all
 20 the shares of the outstanding capital stock thereof, other than directors' qualifying shares, the Company shall not be obliged to pay over to the Trustee hereunder, at the expiration of the said period of six months, any greater sum than an amount in cash equivalent to such proportion of the then unexpended balance of any insurance moneys as the stock of such constituent company then owned by the Company shall bear to the total amount of the outstanding capital stock thereof.

30 SECTION 28. Within ninety days after the close of each fiscal year, the Company will render to the Trustee an officially certified consolidated statement of its income account for the year and a consolidated balance sheet taken at the close thereof, setting forth the financial condition of the Company and its constituent companies for such year. Such statement, if required by the Trustee, shall be audited by certified public accountants appointed or approved by the Trustee.

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ARTICLE THIRD

REDEMPTION OF BONDS

SECTION 29. The Company, at its option, may redeem all the outstanding Bonds, but not part only thereof, on any semi-annual interest date prior to maturity, at 107½ per cent. of the principal amount thereof, if redeemed on or before May 15, 1926, and at 105 per cent. thereof, if redeemed thereafter. 10

In case the Company shall desire so to redeem the outstanding Bonds, it shall publish in two daily newspapers of general circulation, published in the Borough of Manhattan, City and State of New York, once a week for four successive weeks, the first publication to be not less than thirty nor more than thirty-five days before such redemption date, notice of such intended redemption, specifying the date designated for redemption and requiring that the Bonds be then presented for payment at the principal office of the Trustee in the said Borough of Manhattan, City and State of New York. If the ownership of any of the Bonds is registered, notice of redemption shall also be mailed by the Company to the respective registered holders thereof, at least thirty days prior to the redemption date, at their addresses appearing upon the books of the Company. 20

SECTION 30. Notice of redemption having been given as in this Article Third prescribed and an amount in cash sufficient to redeem all the outstanding Bonds having been deposited with the Trustee on or before the redemption date, such Bonds shall, on the date designated in such notice, become due and payable at the said principal office of the Trustee at the said redemption price; and upon the presentation thereof, with all interest coupons maturing subsequently to the said redemption date, such Bonds shall be paid and shall thereupon be cancelled and delivered to the Company, upon its written request therefor. 30 40

Schedule 1.

After the date so fixed for redemption, the Bonds shall cease to bear further interest.

ARTICLE FOURTH

CONTROL OF PLEDGED SECURITIES

10 SECTION 31. The Trustee shall cause all shares of stock at any time pledged with it hereunder to be transferred into its name as Trustee, or into the name of its nominee or nominees; and shall hold the same subject to the terms and conditions of this Agreement.

20 SECTION 32. So long as the Company shall not be in default hereunder, to the knowledge of the Trustee, the Company shall be entitled, from time to time, to collect for its own use all dividends which may be declared on any stock which shall be at the time pledged hereunder and all
30 interest which may accrue upon any moneys deposited with the Trustee hereunder; and the Trustee, upon the written request of the Company, signed by its President or a Vice-President and its Secretary or an Assistant Secretary, shall, from time to time, deliver to the Company, or to its Treasurer or other officer or agent designated in such request, suitable assignments and orders for the payment to it, or to its Treasurer or other officer or agent designated in such request, of any dividends which, from time to time, may be declared or become payable on such
40 stock; and the Trustee, upon written request of the Company, signed as aforesaid, shall from time to time pay over to the Company or to its Treasurer or other officer or agent designated in such request, any and all sums which may be received or collected by the Trustee for dividends upon any stock, and any and all sums which may accrue as interest on any moneys deposited with the Trustee hereunder.

SECTION 33. So long as the Company is not in default hereunder, to the knowledge of the Trustee, the Company

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shall have the right to vote, from time to time, all shares of stock pledged with the Trustee hereunder for all purposes not contrary to the provisions of this Agreement or inconsistent herewith, with the same force and effect as though such shares of stock were not subject to the lien hereof and, from time to time, upon the written request of the Company, signed by its President or a Vice-President and its Secretary or an Assistant Secretary, the Trustee shall execute and deliver, or cause to be executed and delivered, to the Company, or to its nominees, suitable powers of attorney or proxies to vote any such shares of stock as shall at the time be registered in the name of the Trustee, or its nominees; but every such proxy, unless it be limited so as expressly to authorize the casting of a vote only for a specific purpose or purposes authorized by this Agreement or not inconsistent herewith, shall contain a provision substantially in the following form:

“The holder of this proxy shall have no right to vote for, but is instructed to vote against, any lien, mortgage, sale, increase of capital stock, consolidation or charge upon either the property or earnings of the corporation in respect of which this proxy is issued, which shall impair or diminish the rights and interests represented by the stock of the said corporation, except as otherwise expressly provided in the Trust Agreement, dated May 15, 1921, executed between the Porto Rican American Tobacco Company and The National City Bank of New York, as Trustee.”

The Trustee shall be fully protected in the giving of any proxy or proxies or powers of attorney to the Company, pursuant to the provisions aforesaid; and it shall not be responsible for any abuse or mistake in the construction of any such instrument.

SECTION 34. The Trustee may do whatever may be necessary for the purpose of maintaining, preserving, renewing or extending the corporate existence of any con-

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stituent company whose stock is pledged hereunder, and for such purpose may, from time to time, sell, assign, transfer and deliver so many shares of the stock of any such constituent company as may be necessary to qualify persons to act as directors thereof or in any other official relation to any such company. The Trustee may likewise, in its discretion, protect the properties affected by any of the stocks that may, from time to time, be pledged hereunder, by instituting or joining in judicial proceedings, by the purchase at judicial sale of property so affected, by joining in any reorganization of such property or of the companies owning the same, or in any other manner that the Trustee may deem expedient. Whenever the Company, while not in default hereunder to the knowledge of the Trustee; shall in writing so request, which request shall be signed by the President or a Vice-President and the Secretary or an Assistant Secretary of the Company and shall state that the Company has no shares of stock available for that purpose under its control other than shares pledged under this Agreement, the Trustee shall transfer or cause to be transferred to persons designated by the Company, a sufficient number of shares then held by the Trustee hereunder, to qualify such persons to act as directors or in any other official relation to any constituent company; *provided*, that, in every such case, the Trustee shall make such arrangements as it shall deem proper or necessary for the protection of the trusts hereby created in respect of the shares of stock so transferred.

SECTION 35. Whenever the Company shall deliver to the Trustee the following instruments:

(a) A Certificate, signed by the President or a Vice-President of the Company and its Secretary or an Assistant Secretary, verified by one of such officers, certifying that all the properties and assets of either the Porto Rican American Tobacco Company of Porto Rico or of the Porto Rican Leaf

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Tobacco Company, as the case may be, have been disposed of in pursuance of the provisions of Section 23 hereof, setting forth in reasonable detail the character and value of the properties and assets acquired by the Company and each constituent company (if any), respectively. In case such certificate shall show that any part of such properties or assets has been acquired by a constituent company, such Certificate shall also set forth the amount of the issued and outstanding capital stock of such constituent company, and shall certify that all of the same (except directors' qualifying shares) is owned by the Company. 10

(b) In case the Certificate shall show that any part of such properties or assets has been acquired by a constituent company, a copy of the certificate of incorporation of such constituent company, duly certified by the appropriate state authority having the custody of the original of such certificate of incorporation and a copy of the By-laws of such constituent company duly certified by the Secretary thereof, under its corporate seal. 20

(c) An opinion of counsel (who may be counsel for the Company), approved by the Trustee, that all the legal requisites for the transfer of such properties and assets have been complied with, and that the Company or its constituent company or companies, or both the Company and its constituent company or companies, as the case may be, have duly acquired all the properties and assets referred to in the Certificate referred to in paragraph (a) hereof. 30

(d) A copy of a Resolution or Resolutions of the Board of Directors of the Company, certified by its Secretary or an Assistant Secretary, under its corporate seal, requesting the Trustee to release from the lien of this Agreement the stock of the constituent company the properties and assets of which are so certified to have been disposed of, and undertaking that such constituent company shall forthwith be dissolved. In case the Certificate referred to in paragraph (a) hereof shall show that any part of the properties or assets therein referred 40

Schedule 1.

to has been acquired by a constituent company, such Resolutions shall also authorize and direct the pledge with the Trustee of all the issued and outstanding capital stock of such constituent company, which shall be the amount thereof set forth in the said Certificate.

10 (e) In case the said Resolutions shall authorize the pledge of the stock of any constituent company, certificates for such stock, in form for transfer, or accompanied by duly authorized transfer powers.

Upon the receipt of the instruments above provided for, the Trustee shall release from the lien of this Agreement and deliver to or upon the written order of the Company, signed by its President or a Vice-President, all the stock then pledged hereunder of the constituent company, the properties and assets of which are so certified to have been disposed of.

20 SECTION 36. The Trustee may accept any certificate, written request, order or other instrument delivered to it pursuant to any of the provisions of this Article Fourth as conclusive proof of the facts therein set forth, and the Trustee shall be fully protected for or in respect of any action taken or suffered by it under any of the provisions hereof in reliance thereon; but the Trustee may, in its discretion, require such other and further proof of any such fact or facts as, under the circumstances, it may deem proper.

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ARTICLE FIFTH

SINKING FUND

SECTION 37. In each semi-annual period, commencing with the semi-annual period ending November 15, 1921, the Company will set aside the sum of \$157,500, in cash, as and for a Sinking Fund for the retirement of the Bonds issued hereunder, which sum, so set aside, the Company will apply, or cause to be applied by its agent appointed
40 for that purpose, to the purchase of Bonds in the open

Schedule 1.

market, if obtainable, at prices up to but not exceeding 105 per cent. of the principal amount thereof, excluding accrued interest, which Bonds, so purchased, the Company shall forthwith deliver or cause to be delivered to the Trustee. In the event, however, that the Company, or its agent, shall not have been able, in any semi-annual period, to purchase sufficient Bonds, at or below 105 per cent. of the principal amount thereof, excluding accrued interest, to exhaust the entire amount in the Sinking Fund, any unexpended balance thereof shall be credited upon the next semi-annual instalment, in discharge, *pro tanto*, of the Company's obligation with respect thereto. All Bonds so purchased for the Sinking Fund and delivered to the Trustee, shall be cancelled by the Trustee and redelivered to the Company, upon its written request therefor; and no Bonds shall thereafter be issued in lieu thereof. 10

Accrued interest paid by the Company upon the purchase of any Bonds shall be paid from funds other than Sinking Fund moneys. 20

ARTICLE SIXTH

REMEDIES IN CASE OF DEFAULT

SECTION 38. In case any one or more of the following events (hereinafter called "defaults") shall happen:

(a) Default in the payment of the principal of any of the Bonds when due, whether at maturity or pursuant to notice of redemption, or otherwise; 30

(b) Default in the payment of any instalment of interest on any of the Bonds, which default shall have continued for the period of thirty days;

(c) Default in the performance of, or a violation of, any other covenant, condition or agreement on the part of the Company in the Bonds or in this Agreement contained, and such default or violation shall continue unremedied for a period of sixty days after written notice thereof shall have been given to the Company by the Trustee, which may give such 40

Schedule 1.

notice in its discretion, and shall do so upon the written request of the holders of twenty-five per cent. in aggregate principal amount of the Bonds then outstanding; or

10 (d) The Company shall be adjudicated a bankrupt by decree of a court of competent jurisdiction, or, by order of any such court, a receiver of the property of the Company shall be appointed, and such order shall have been continued in effect for a period of sixty days, or the Company shall file a voluntary petition in bankruptcy or shall make an assignment for the benefit of the creditors;

then, in each and every such case, the Trustee, by written notice to the Company, may, and shall, upon the written request of the holders of twenty-five per cent. in aggregate principal amount of the Bonds then outstanding, declare the principal of all the Bonds then outstanding to be due and payable immediately; and, upon such
20 declaration, the same shall become immediately due and payable, anything in this Agreement or in the Bonds contained to the contrary notwithstanding; *provided*, that if, at any time, either before or after the principal of the Bonds shall have been so declared due and payable, but before any sale of the pledged property shall have been made, all arrears of interest upon all the Bonds, with interest on overdue instalments of interest at the rate of eight per cent. per annum, together with the reasonable charges and expenses of the Trustee, its agents
30 and attorneys, shall have been paid by the Company, and any and every other default by reason of which the principal of the Bonds may or might have been declared due hereunder shall have been remedied and made good, then, in each such case, the holders of a majority in aggregate principal amount of the Bonds then outstanding, by written notice to the Company and to the Trustee, may waive such default and its consequences and rescind any such declaration; but no such waiver shall extend to or affect any subsequent default or impair any right
40 consequent thereon.

Schedule 1.

SECTION 39. If default be made hereunder in any of the respects specified in Section 38 hereof, and such default shall continue for the period, if any, therein specified, then, in each and every such case, the Trustee may and, upon the written request of the holders of twenty-five per cent. in aggregate principal amount of the Bonds then outstanding, shall, either (a) offer for sale and sell the pledged property then in its possession, or (b) proceed by a suit or suits at law or in equity, as the Trustee may be advised by counsel, to enforce the payment of the Bonds or the performance of any of the covenants or conditions in respect of which the Company may be in default hereunder, or to foreclose this Agreement and sell the pledged property under the judgment or decree of a court of competent jurisdiction. 10

SECTION 40. Any sale or sales hereunder, unless a court of competent jurisdiction shall otherwise direct, shall be made at public auction at such place in the Borough of Manhattan, City of New York, and at such times and on such terms as the Trustee may determine, and the pledged property may be sold in such lots and such sales may be conducted in such manner as the Trustee may from time to time determine, or as may from time to time be directed by the holders of a majority in aggregate principal amount of the Bonds then outstanding. Notice of any such sale, whether under power of sale herein granted or under judicial proceedings, shall state the time when and the place where the same is to be made, shall contain a brief description of the pledged property to be sold and shall be published twice a week for two successive weeks prior to the date fixed for such sale in two daily newspapers of general circulation published in the Borough of Manhattan, City of New York; and such other notice shall also be given as may be required by any statute or rule or order of court. 20 30

Schedule 1.

10 The Trustee shall have power, in its discretion, to adjourn any sale, from time to time, as to the whole or any part of the pledged property and, if so adjourned to make such sale upon the day to which the adjournment is had, without further notice. Any sale made as herein provided shall be a perpetual bar, both at law and in equity, against the Company and its successors, and against all persons claiming or to claim the pledged property, or any part thereof, by, through or under it or them.

20 SECTION 41. Upon the sale of the pledged property, whether under the power of sale herein granted or under judicial proceedings, every purchaser shall be entitled, in making payment therefor, after paying in cash so much as may be necessary to cover the costs and expenses of the sale and of the proceedings incident thereto, and all other charges that may be required by decree or otherwise to be paid in cash, including the compensation of the Trustee and its expenses, to appropriate and use toward the payment of the remainder of the purchase price any of the Bonds and interest coupons outstanding hereunder, reckoning each Bond and interest coupon so appropriated and used at such sum as shall be payable thereon out of the net proceeds of the sale. If the net proceeds of such sale shall be sufficient to pay such Bonds and interest coupons in full, they shall be cancelled and, upon written demand, surrendered by the Trustee to or upon the order of the Company; but if the sum applicable in respect thereto is not sufficient to pay such Bonds in full, the sum so allowed on account thereof shall be noted thereon as paid.

40 At any sale, the Trustee, either in behalf of the holders of the Bonds or in its own behalf, or any holder of any Bond, may bid for and may purchase such property, and may make payment therefor as aforesaid, and, upon compliance with the terms of sale, may hold, retain and dispose of such property without further accountability.

Schedule 1.

In case of any sale of any part of the pledged property, the whole of the principal of the Bonds then outstanding, if not previously due, shall become immediately due and payable, anything in the Bonds or in this Agreement contained to the contrary notwithstanding.

SECTION 42. The proceeds of any sale of the pledged property, whether under the power of sale hereby granted or pursuant to judicial proceedings, together with any other sums which may then be held by the Trustee under any of the provisions of this Agreement, shall be applied, subject to the provisions of Section 10 hereof, as follows: 10

First. To the payment of the costs, expenses, fees, and other charges of such sale, and a reasonable compensation to the Trustee, its agents and attorneys, and to the payment of all expenses and liabilities incurred and advanced, or disbursements made, by the Trustee;

Second. To the payment of the whole amount then due and unpaid for either principal or interest, or for both principal and interest, upon the Bonds, with interest on the overdue instalments of interest at the rate of eight per cent. per annum; and, in case such proceeds shall be insufficient to pay in full the whole amount so due and unpaid, then to the payment of such principal and interest ratably, according to the aggregate of such principal and the accrued and unpaid interest, without preference or priority of principal over interest, or of interest over principal, or of any instalment of interest over any other instalment of interest; 20 30

Third. To the payment of the remainder, if any, to the Company, its successors or assigns, or to whomsoever may be lawfully entitled to receive the same, or as a court of competent jurisdiction may direct.

SECTION 43. If the Company shall make default in any of the respects specified in Section 38 hereof, and such default shall continue for the period, if any, therein specified, then in each and every such case the Trustee shall cancel all assignments or orders for the payment 40

Schedule 1.

of dividends, and all proxies with respect to any of the pledged stock theretofore delivered by it to the Company, and the Trustee shall thereupon be entitled to receive and collect, for the benefit of the holders and owners of the Bonds, all dividends that may thereafter be declared on any shares of stock pledged hereunder and all sums which may thereafter accrue upon any moneys deposited with the Trustee hereunder, and shall itself vote all shares of stock then pledged hereunder, in such manner and for such purposes as it may in its discretion deem advisable. The Trustee shall apply any and all moneys so received and collected by it, subject to the provisions of Section 10 hereof, as follows:

First. In case the principal of the Bonds shall not have become due, to the payment of the interest in default thereon in the order of the maturity of the instalments of such interest, with interest thereon at the rate of eight per cent. per annum, such payments to be made ratably to the persons entitled thereto, without any discrimination or preference; or

Second. In case the principal of the Bonds shall have become due, by declaration or otherwise, to the payment of the accrued interest thereon (with interest on overdue instalments thereof at the rate of eight per cent. per annum) in the order of the maturity of such instalments, and, if any surplus remains, toward the payment of the principal of the Bonds, then due; such payments in every instance to be made ratably to the persons entitled thereto, without any discrimination or preference.

Upon the payment in full, as above provided, of whatever sum or sums may have been due for principal or for interest, or both, or payable for other purposes, and upon the fulfillment and performance of all other obligations of the Company in respect of which it was in default under this Agreement, the Company shall thereafter be entitled to receive the income from the pledged property and to vote the pledged stock, unless the same shall have been

Schedule 1.

sold as in this Article Sixth provided, in the same manner and to the same extent as though no default had occurred.

SECTION 44. If default be made by the Company in the payment of either the principal or the interest of any of the Bonds, whether the same shall become due by maturity, declaration, notice of redemption or otherwise, then, in each such case, upon demand of the Trustee, the Company agrees to pay to the Trustee for the benefit of the holders of the Bonds and interest coupons then outstanding, the whole amount then due and payable on all such outstanding Bonds and interest coupons, with interest upon overdue instalments of interest at the rate of eight per cent. per annum, and, in addition thereto, such further amount as shall be sufficient to cover the cost and expenses of collection, including a reasonable compensation to the Trustee, its agents, attorneys and counsel, and any expenses or liabilities incurred by the Trustee hereunder; and in case the Company shall fail to pay the same forthwith upon demand, the Trustee, in its own name and as trustee of an express trust, shall be entitled to recover judgment against the Company for the whole amount thereof and to issue execution thereon against the whole or any part of the property of the Company, real or personal.

Any moneys collected by the Trustee under this Section 44 shall be applied by the Trustee in the same order and in the same manner as provided in Section 42 hereof for the application of the proceeds of the sale of the pledged property.

SECTION 45. All remedies conferred by this Agreement shall be deemed cumulative and not exclusive, and shall not be so construed as to deprive the Trustee of any legal or equitable remedy by judicial proceedings appropriate to enforce the conditions, covenants and agreements of this Agreement.

No delay or omission by the Trustee or by any holder of any Bond to exercise any right or power arising from

Schedule 1.

or on account of any default hereunder shall impair any such right or power, or shall be construed to be a waiver of any such default or an acquiescence therein; and every power and remedy given by this Agreement to the Trustee or to the holders of the Bonds may be exercised, from time to time, and as often as may be deemed expedient.

10 Anything herein contained to the contrary notwithstanding, the holders of seventy-five per cent. in aggregate principal amount of the Bonds outstanding hereunder, from time to time, shall have the right to direct and control the action of the Trustee in making any sale of the pledged property, or in any proceedings by it to enforce the payment of the Bonds or the performance of any of the covenants and conditions hereof, or in foreclosing this Agreement, or in any other action or proceeding hereunder.

20 SECTION 46. No holder of any Bond issued hereunder shall have the right to institute any suit, action or proceeding, at law or in equity, for the collection of any sum due from the Company on such Bond, for principal or interest, or upon or in respect of this Agreement, or for the execution of any trust or power hereof, or for any other remedy under or upon this Agreement, unless such holder shall previously have given to the Trustee written notice of an existing default, and unless, also, such holder
30 or holders shall have tendered to the Trustee security and indemnity satisfactory to it against all costs, expenses and liabilities which might be incurred in or by reason of such action, suit or proceeding, and unless, also, the holders of twenty-five per cent. in aggregate principal amount of the Bonds then outstanding shall have requested the Trustee in writing to take action in respect of such default and the Trustee shall have declined or failed to take such action within thirty days thereafter; it being intended that no one or more holders of Bonds shall have
40 any right in any manner to enforce any right hereunder,

Schedule 1.

or under or in respect of any of the Bonds, except in the manner herein provided, and for the equal, proportionate benefit of all holders of the outstanding Bonds.

ARTICLE SEVENTH

SUNDRY PROVISIONS

SECTION 47. Any demand, request or other instrument required or authorized by this Agreement to be signed or executed by the holders of any Bonds may be in any number of concurrent writings of similar tenor, and may be signed or executed by such holders in person, or by attorney appointed in writing. Proof of the execution of any such demand, request or other instrument, or of the writing appointing any such attorney, and of the ownership by any person of any Bonds, shall be conclusive in favor of the Trustee and of the Company, with regard to due action taken by the Trustee or by the Company pursuant to such instrument, if such proof be made in the following manner. 10 20

The fact and date of the execution by any person of any such demand, request or other instrument or writing may be proved by the certificate of any notary public or any officer of any jurisdiction, authorized by the laws thereof to take acknowledgments of deeds to be recorded in any State within the United States of America, certifying that the person signing such request or other instrument acknowledged to him the execution thereof, or by an affidavit of a witness to such execution, duly sworn to before any such notary public or other officer. 30

The fact that the holding of any Bonds the ownership of which shall not at the time be registered and the amounts and serial numbers of such Bonds and the date of holding the same, may be proved by a certificate executed by any trust company, bank, banker or other depository (wherever situated), if such certificate shall be deemed by the Trustee to be satisfactory, showing that at the date 40

Schedule 1.

10 therein mentioned the person named in such certificate had on deposit with or exhibited to such depositary the Bonds described in such certificate. For all purposes of this Agreement and of any proceeding pursuant hereto for the enforcement hereof or otherwise, such person shall be deemed to continue to be the holder of such Bonds until the
Trustee shall have received notice in writing to the contrary. The ownership of any Bonds, the ownership of which shall at the time be registered, shall be proved by the register of such Bonds.

20 SECTION 48. As to all Bonds the ownership of which shall at the time be registered, the person in whose name the same shall be registered on the books of the Company shall for all purposes of this Agreement be deemed and regarded as the owner thereof, and payment of or on account of the principal of any such Bond shall be made only to or upon the order of such registered holder. Such
payment shall be valid and effectual to satisfy and discharge the liability of the Company upon such Bonds to the extent of the sum or sums so paid.

30 The holder of any Bond the ownership of which shall not at the time be registered and the holder of any interest coupon pertaining to any Bond, whether the ownership of such Bond be registered or not, shall, for all purposes of this Agreement, be treated as the absolute owner of such Bond or interest coupon; and neither the Company nor the Trustee shall be affected by any notice to the contrary.

40 SECTION 49. No recourse shall be had for the payment of either principal or interest of any Bond or for any claim based thereon or otherwise in any manner in respect thereof or in respect of this Agreement, to or against any stockholder, officer or director of the Company, past, present or future, or his legal representatives or assigns, either directly or through the Company, by virtue of any statute, or by the enforcement of any assessment or penalty, or in any manner.

Schedule 1.

SECTION 50. The following are the definitions of various terms employed in this Agreement:

"Net current assets", shall mean current assets of the Company and its constituent companies, less its and their current liabilities.

"Current assets", shall mean current assets of the Company and its constituent companies, whether so stated or not, and shall include: 10

(a) Cash in bank and on hand; good and collectable notes, accounts and bills receivable contracted in the ordinary course of business (excluding accounts, notes and bills receivable contracted through the sale of the Company's capital stock and loans to other corporations or individuals, other than the Porto Rican Leaf Tobacco Company, unless secured by collateral consisting of readily marketable securities) if such notes, accounts and bills receivable are due within one year, accrued interest, rents and royalties receivable; prepaid insurance, interest and taxes, and advances on open account made to the Porto Rican Leaf Tobacco Company (hereinbefore referred to); *provided*, that from notes, accounts, bills and trade acceptances receivable there shall be excluded all bad or doubtful items. 20

(b) Manufactured products, products in process of manufacture and materials and supplies; such products, materials and supplies to be valued at actual cost or at not more than market value if that be lower. 30

(c) Obligations of the United States Government, taken at not more than their market value.

(d) Other readily marketable securities paying regular interest or dividends, valued at not more than the market value thereof (excluding bonds or stocks issued by the Company or by a constituent company, or issued by corporations of which the Company and its constituent companies, or any of them, singly or collectively, shall at the time own or control, directly or indirectly, fifty per cent. of the capital stock). 40

Schedule 1.

"Current liabilities", shall include:

(a) Accounts, bills and notes payable; loans from banks and bankers; salaries, wages, interest, rents, royalties and taxes accrued, including income and war excess profits taxes.

(b) All other liabilities of any constituent company.

10

"All liabilities", shall include all liabilities, direct or contingent, of the Company and its constituent companies, whether so stated or not.

THE FOREGOING DEFINITIONS relate to a consolidated balance sheet of the Company and of its constituent companies, after eliminating all intercompany items. Such consolidated balance sheet shall, however, include only such proportion of the respective current assets and current liabilities, shown on a constituent company's balance sheet as the stock of such constituent company owned or

20 controlled by the Company shall bear to the total outstanding capital stock of such constituent company.

"Fixed assets", shall mean real estate, buildings, machinery, plant and equipment, and any stocks not of the character defined as current assets.

"Contingent liabilities", shall include only liabilities incurred as accommodation maker, endorser or acceptor, guarantor or surety on or of the obligations or contracts of corporations, associations or individuals other than those of the Company or of any constituent company.

30

SECTION 51. All the covenants, stipulations and agreements in this Agreement contained by or on behalf of the Company are and shall be for the sole and exclusive benefit of the parties hereto and of the respective holders and owners of the Bonds and interest coupons hereby secured, and shall bind and apply to the successors and assigns of the Company, whether so expressed or not. Whenever, in this Agreement, either of the parties hereto is referred to, such reference shall be deemed to include the successor or successors and assigns of such

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Schedule 1.

party, and all covenants, promises and agreements in this Agreement contained by or on behalf of the Company, or by or on behalf of the Trustee, shall bind and inure to the benefit of the respective successors and assigns of such party, whether so expressed or not.

ARTICLE EIGHTH

10

CONCERNING THE TRUSTEE

SECTION 52. The Trustee accepts the trusts of this Agreement and agrees to execute them upon the terms and conditions hereof, including the following, to all of which the Company and the holders of the Bonds agree:

The Trustee shall be under no obligation to see to the performance or observance of any of the covenants or agreements on the part of the Company.

The Trustee shall not be responsible in respect of the validity of this Agreement or of the Bonds, nor for the sufficiency of the security provided hereby; and it makes no representation in respect thereof.

20

The Trustee shall not be responsible in any manner for the operations of the Sinking Fund provided for in Article Fifth hereof, nor for any dealings of the Company or of any agent of the Company therewith, nor to see that any Sinking Fund instalment is set aside or applied in accordance with the provisions of the said Article Fifth; and it assumes no duty or obligation with respect thereto.

30

The Trustee shall not be responsible for the recitals herein or in the Bonds contained, all of which are made by the Company, solely; nor shall the Trustee be responsible in any manner for effecting or renewing any insurance upon any of the property of the Company, or of any constituent company, or for the application of the proceeds of any such insurance, or for the application of the proceeds of any sale of fixed assets as provided in Section

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Schedule 1.

22 hereof, or for the payment of any tax, assessment or imposition which may at any time be levied or assessed against the Company or any constituent company or against any of the property of the Company or of any constituent company.

10 The Trustee shall be entitled to reasonable compensation for all services rendered hereunder, and such compensation, as well as all reasonable expenses necessarily incurred and actually disbursed hereunder by the Trustee, the Company agrees to pay; and, until so paid, the Trustee shall have a lien therefor upon the pledged property, preferential to the Bonds.

20 Until the Trustee shall have received written notice to the contrary from the holders of not less than twenty-five per cent. in aggregate principal amount of the Bonds then outstanding, the Trustee may, for all the purposes of this Agreement, assume that no default has been made in the payment of any of the Bonds or of the interest thereon, or in the observance or performance of any other of the covenants contained in the Bonds or in this Agreement, and that the Company is not in default under this Agreement.

30 The Trustee shall not be under any obligation to take any action hereunder, which in its opinion will be likely to involve it in expense or liability, unless one or more holders of Bonds shall, as often as required by the Trustee, furnish it security and indemnity satisfactory to it against such expense and liability; nor shall the Trustee be required to take any action in respect of any default hereunder unless requested by an instrument in writing signed by the holders of not less than twenty-five per cent. in aggregate principal amount of the Bonds then outstanding.

40 All moneys coming into the hands of the Trustee may be treated by it, until such time as it is required to pay out the same, as a general deposit, and the interest, if

Schedule 1.

any, paid thereon shall be at such rate as the Trustee allows on similar deposits.

All rights of action under this Agreement may be enforced by the Trustee without the possession of any Bonds, or the production thereof on the trial or other proceedings relative thereto.

The Trustee, in its individual capacity, may acquire and hold any Bonds issued hereunder with the same right and to the same extent as if it were not such Trustee. 10

Any action taken by the Trustee at the request or with the consent of any person who at the time is the owner of any Bond shall be conclusive and binding upon all future holders of such Bond.

The Trustee shall not be answerable for the default or misconduct of any agent or attorney appointed by it in pursuance hereof, if such agent or attorney shall have been selected with reasonable care, nor for any error of judgment, nor for any act done or omitted by it in good faith, nor for any mistake of fact or of law, nor for anything whatever in connection with this Agreement, except for its own wilful misconduct. 20

The Trustee may construe any of the provisions of this Agreement; and any construction placed upon any provision hereof by the Trustee in good faith shall be binding upon the Company and upon the holders of all Bonds issued hereunder. 30

The Trustee may advise with legal counsel; and any action under this Agreement, taken or suffered in good faith by the Trustee in accordance with the opinion of counsel, shall be conclusive on the Company and on all holders of Bonds, and the Trustee shall be fully protected in respect thereto.

The Trustee shall be protected in acting upon any notice, request, waiver, consent, certificate, affidavit, indemnity bond or other instrument believed by it to be genuine and to be signed by the proper party or parties. 40

Schedule 1.

SECTION 53. The Trustee or any successor may resign as trustee hereunder by filing with the Company an instrument in writing, resigning the trusts hereby created, two weeks (or such shorter time as may be accepted by the Company as adequate) before such resignation shall take effect.

- 10 Any trustee hereunder may be removed at any time by an instrument in writing filed with the trustee for the time being acting hereunder and executed by the holders of two-thirds in aggregate principal amount of the Bonds then outstanding; *provided*, there be paid to the trustee so removed all moneys due to it hereunder.

- SECTION 54. In case, at any time, any trustee acting hereunder shall resign or shall be removed or otherwise shall become incapable of acting, a successor may be appointed by the holders of a majority in aggregate
20 principal amount of the Bonds then outstanding by an instrument signed by such holders or their attorneys in fact duly authorized; but until a new trustee shall be so appointed hereunder, the Company may, by an instrument in writing, executed by order of its Board of Directors, appoint a trustee to fill such vacancy. Any new trustee so appointed by the Company shall immediately be superseded by a trustee appointed in the manner above provided by the holders of a majority in
30 aggregate principal amount of the Bonds.

Any trustee appointed under any of the provisions of this Article Eighth shall always be a national banking association, bank or trust company having an office in the Borough of Manhattan, City of New York, and having a capital and surplus aggregating at least One Million Dollars, if there shall be such a banking association, bank or trust company willing and able to accept the trusts upon reasonable or customary terms.

- SECTION 55. Any successor trustee appointed here-
40 under shall execute and deliver to the Company and to

Schedule 1.

the retiring trustee an instrument accepting such appointment hereunder, and thereupon such successor trustee shall be invested with the same authority, rights, powers, discretion and duties herein provided for the Trustee; but the trustee so resigning or removed, shall, at the request of the Company, its successors or assigns, or of the successor trustee so appointed, and upon payment of its charges and disbursements then unpaid, make and execute such deeds, conveyances, assignments or assurances to its successor as its successors may reasonably require, and shall deliver to such successor in negotiable form or accompanied by suitable transfer powers all the pledged property and cash then in its possession hereunder. 10

IN WITNESS WHEREOF, the Company and the Trustee have caused this Agreement to be signed by their respective Presidents or Vice-Presidents, and their respective corporate seals to be hereto affixed, duly attested, as of the day and year first above written. 20

PORTO RICAN AMERICAN TOBACCO COMPANY,

By F. L. KENNEY
Vice-President

[CORPORATE SEAL]

Attest:

H. CATLIN
Asst. Secretary

30

THE NATIONAL CITY BANK OF NEW YORK,

By THOS. A. REYNOLDS
Vice-President

[CORPORATE SEAL]

Attest:

C. H. CLARK
Assistant Cashier

40

Schedule 1.

STATE OF NEW YORK, }
 County of New York. }

On the 25th day of May, 1921, before me personally came
 F. L. KENNEY, to me known, who, being by me duly sworn,
 did depose and say, that he resides in the City and State
 of New York; that he is the President of the PORTO RICAN
 10 AMERICAN TOBACCO COMPANY, one of the corporations de-
 scribed in and which executed the foregoing instrument;
 that he knows the seal of the said corporation; that the
 seal affixed to the said instrument is such corporate seal;
 that it was so affixed by authority of the Board of Di-
 rectors of the said corporation, and that he signed his
 name thereto by like authority.

R. L. DAVIS

Notary Public, Kings County No. 191
 Kings County Register No. 3014
 Certificate filed in New York County
 20 [NOTARIAL SEAL] New York County Clerk's No. 101
 New York County Register's No. 3099
 Commission expires March 31, 1923

STATE OF NEW YORK, }
 County of New York. }

On the 25th day of May, 1921, before me personally
 came THOMAS A. REYNOLDS, to me known, who, being by
 me duly sworn, did depose and say, that he resides in the
 City and State of New York; that he is a Vice-President
 of THE NATIONAL CITY BANK OF NEW YORK, one of the
 corporations described in and which executed the fore-
 going instrument; that he knows the seal of the said cor-
 poration; that the seal affixed to the said instrument is
 such corporate seal; that it was so affixed by authority of
 30

Schedule 2.

the Board of Directors of the said corporation, and he signed his name thereto by like authority.

R. L. DAVIS

Notary Public, Kings County No. 191

Kings County Register No. 3014

Certificate filed in New York County

[NOTARIAL SEAL] New York County Clerk's No. 101

New York County Register's No. 3099

Commission expires March 31, 1923

10

Schedule 2.**PORTO RICAN-AMERICAN TOBACCO COMPANY****ANNUAL REPORT**

Fiscal Year Ended December 31st, 1922.

20

Jersey City, N. J., February 21st, 1923.

Treasurer's Report to the Stockholders of
Porto Rican-American Tobacco Company of New Jersey.

The Treasurer respectfully submits the following financial report of your Company for the year ended December 31st, 1922.

There has been no change during the year in the amount of authorized Capital Stock (\$10,000,000.00 par value), though additional stock of the par value of \$7,700.00 was issued in exchange for scrip and fractional certificates surrendered, making the amount of Capital Stock outstanding at the end of the year \$6,277,850.00.

30

There were purchased and cancelled during the year \$456,000.00 par value of our 8% Sinking Fund Gold Bonds, leaving a balance outstanding at the end of the year of \$2,385,500.00 of the original issue of \$3,000,000.00 The difference between par value and cost of the Bonds so purchased has been written off as an expense.

40

Schedule 2.

While the results from operations during the latter part of the year were very satisfactory, they were not sufficient to offset losses from operations earlier in the year.

10 The statement herewith presented is a consolidated statement of this Company's business with that of its subsidiaries, all of whose stock is owned by this Company.

Gross Profits for the year ended December

31, 1922\$1,091,636.47

Deduct:—

Advertising, Selling, Administrative
and other expenses 997,945.54

Operating Profit\$ 93,690.93

20 *Add:—*

Other Income 130,422.23

Total Income\$ 224,113.16

Deduct:—

Interest on Bonds, Scrip,
Bills Payable, etc\$331,333.23

Inventory Losses 283,018.34

614,351.57

30

Net Loss for year\$ 390,238.41

Add:—

Surplus December 31, 1922\$ 399,041.98

Surplus December 31, 1922 \$ 8,803.57

Schedule 2.

PORTO RICAN-AMERICAN TOBACCO COMPANY

CONSOLIDATED BALANCE SHEET

December 31st, 1922.

Assets:

Real Estate, Machinery, Fixtures, etc	\$ 1,968,423.90	10
Leaf Tobacco, Manufactured Stock, Operating Supplies, etc.	4,057,866.75	
Accounts and Bills Receivable	2,018,591.83	
Cash	637,804.24	
Deferred Charges	170,435.77	
Investment in Other Companies	261,653.32	
Goodwill, Trademarks, etc.	1,500,000.00	
Total Assets	\$10,614,775.81	

Liabilities:

Capital Stock outstanding	\$ 6,277,850.00	20
Scrip redeemable in Capital Stock	36,423.00	
Scrip, Series No. 10	149,026.50	
Ten Year 8% Sinking Fund Gold Bonds ...	2,385,500.00	
Accounts and Bills Payable	1,038,880.80	
Reserved for Depreciation	718,291.94	
Total Liabilities	\$10,605,972.24	30
Surplus December 31, 1922	\$ 8,803.57	

Respectfully submitted,

A. H. NOBLE, *Treasurer*

*Schedule 3.***Schedule 3.***Porto Rican-American Tobacco Company*

185 MADISON AVENUE

N. E. Cor. 34th Street

NEW YORK, N. Y.

10

May 10, 1923

TO THE STOCKHOLDERS OF
PORTO RICAN-AMERICAN TOBACCO COMPANY:

Notice is hereby given that a Special Meeting of the stockholders of said Company will be held at the the Company's principal office, 15 Exchange Place, Jersey City, New Jersey, at eleven o'clock A. M., on Thursday, May 31, 1923, for the purpose of considering and acting upon the following resolutions adopted by the Board at a meeting held on the 3rd day of May, 1923, and for the transaction of such other business as may properly come before the meeting:

20

“RESOLVED: That it is advisable and for the best interest of the Company to so amend the certificate of incorporation and increase its capital stock as that:

30

(1) In addition to the present authorized capital stock of 100,000 shares of the par value of \$100 per share, all of one class (hereinafter referred to as Class A common stock only for the purpose of differentiating it in these resolutions from the proposed new common stock denominated Class B Common stock), there be authorized an issue of 100,000 shares of Class B Common stock, without nominal or par value and without voting power, which the Board of Directors may issue in their discretion in whole or in part to the holders of Class A Common stock as a stock dividend, or offer to them the right to subscribe for same, or otherwise dispose of in accordance with law. Said Class B common stock shall enjoy the privileges and be subject to the further following restrictions and conditions:

40

Schedule 3.

(a) That when and not until cumulative dividends of seven per cent shall have been paid upon Class A common stock there may be paid dividends in the aggregate equal to \$7.00 per share on Class B common stock for the fiscal year. As to all further dividends that may be declared for the fiscal year, Class A common stock and Class B common stock shall share equally, share and share alike. 10

(b) Upon dissolution of the corporation, or upon final distribution of its assets, and after the payment of its debts, Class A common stock shall be redeemed at par with accumulated dividends, if any, if the assets of the corporation, including surplus and accumulated profits, are sufficient; if the assets are not sufficient, then all said assets or their proceeds shall be distributed ratably among the holders of Class A common stock. If the assets are more than sufficient for such redemption, all remaining thereafter shall be distributed ratably amongst the holders of said two classes of common stock. 20

(2) The Board of Directors may issue any authorized and unissued Class A common stock and Class B common stock, or either, at such times, respectively, and on such terms as in its discretion may seem best and in accordance with law, and upon issuance of Class A common stock the holders of Class B common stock shall not have any preferential right to receive or subscribe for the same.

(3) In order that any other class of stock may be authorized, not only the consent of those holding two-thirds of the issued and outstanding shares of Class A common stock shall be given, but as well the consent of those holding two-thirds of the issued and outstanding Class B common stock. 30

FURTHER RESOLVED: That a special meeting of the stockholders be and the same is hereby called to be held on the 31st day of May, 1923, at eleven o'clock A. M., at the principal office of the Company, 15 Exchange Place, Jersey City, New Jersey, for the purpose of considering and taking action on the foregoing resolution for the amendment and increase of capitalization of the certificate of incor- 40

Schedule 3.

poration of the Company and that due notice of such meeting be given and that upon obtaining the assent in writing and the approving vote of the stockholders of the Company as required by law, the certificate of incorporation be amended and the Board of Directors be authorized and empowered to issue stock as hereinabove provided.

10 FURTHER RESOLVED: That in the event of the certificate of incorporation being amended and the capital of the corporation increased as hereinabove provided, the Board of Directors be empowered to forthwith give to the holders of Class A common stock the privilege of subscribing and taking one share of Class B common stock for each share of Class A common stock held by them, respectively, in consideration of \$25.00 per share."

20 In the event of your being unable to be present at the meeting, you are requested to kindly sign and return the enclosed proxy immediately. The proper revenue stamp will be affixed by the Company.

Very respectfully yours,

H. CATLIN,
Secretary.

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*Schedule 4.***Schedule 4.***Porto Rican-American Tobacco Company*

185 MADISON AVENUE

N. E. Cor. 34th Street

NEW YORK, N. Y.

May 10, 1923.

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**TO THE STOCKHOLDERS OF
PORTO RICAN-AMERICAN TOBACCO COMPANY:**

Your Board of Directors on the 13th March, 1923, adopted certain resolutions calling a special meeting of the stockholders and recommending that the charter of the Company be amended increasing the authorized capital stock; the conversion of the present stock of the Company into seven per-cent cumulative preferred stock; the issuing of a like number of shares of common stock without nominal or par value and disposing of the latter without first offering it to the present stockholders.

20

Some of the stockholders strongly insisted that the right to take the non-par common stock should be given to the stockholders in proportion to their holdings of the present outstanding stock.

Out of deference to the views of the stockholders opposing the plan, your Board of Directors reconsidered and rescinded the resolutions calling for a Special Meeting of the stockholders and definitely abandoned the plan, and in lieu thereof they are now proposing the new plan evidenced by resolutions of the Board adopted on May 3, 1923, a copy of which is set out in the notice herewith enclosed calling the Special Meeting of stockholders on May 31, 1923. Amongst other things, it appears from these resolutions that the Board recommends that the charter be amended so as to authorize the increase of the capital stock of the Company, the same being all of one class, by adding thereto 100,000 additional shares desig-

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Schedule 4.

nated as Class B common stock without nominal or par value or voting rights, and that there be offered to the present stockholders one share of Class B common stock at \$25.00 per share for each share of the present stock held by them, respectively. It is deemed but proper that you be advised that the entire surplus of the Company has
10 been consumed. It is of great importance that necessary working capital be provided, and it is for the purpose of raising the same that the Company is seeking to sell an additional amount of stock of the Company.

Due to the several bad years experienced by the Company, mainly attributable to labor conditions in Porto Rico, your Company, as you will recall, sought and secured in 1921, at a time when there was great stringency in the money market, a loan of \$3,000,000, for which it issued its Ten Year Gold Bonds at the then prevailing
20 high rate of eight per-cent interest. There was a provision for a sinking fund, through which up to the present, something more than the required number of bonds have been purchased and retired. The bonds are redeemable at any semi-annual interest due date. We submit that the Company should be relieved as quickly as is practicable of continuing to carry the burden of interest on these bonds. Besides, your Company needs additional working capital for the general expansion of its business and especially for the purchase of the present crop of tobacco, which is of good quality. To the extent it can
30 acquire tobacco of the present crop at fair and reasonable prices, it is thought to be good policy to invest in the same, to the extent of the needs of the Company.

It is the hope and desire of your Board of Directors that the stockholders will appreciate the conditions and promptly respond to the notice of the special meeting of stockholders to consider and act upon the resolutions of the Board.

Very respectfully yours,

L. TORO,
President.

*Schedule 5.***Schedule 5.****PORTO RICAN-AMERICAN TOBACCO COMPANY****ANNUAL REPORT**

Fiscal Year Ended December 31st, 1921.

Jersey City, N. J., March 3rd, 1922. 10

Treasurer's Report to the Stockholders of

Porto Rican-American Tobacco Company of New Jersey.

The Treasurer respectfully submits the following financial report of your Company for the year ended December 31st, 1921.

The stockholders at a special meeting on March 10, 1921, authorized the increase of the Capital Stock from \$5,000,000.00 par value to \$10,000,000.00 par value for the purpose of redeeming the dividend scrip series 1 to 9 inclusive at par, and this was made effective March 31, 1921. Through the redemption of this scrip, and other scrip and fractional certificates previously authorized, the Capital Stock was increased during the year from \$4,965,350.00 to \$6,270,150.00. 20

Under date of May 15, 1921, the Company issued \$3,000,000.00 Ten Year 8% Sinking Fund Gold Bonds for the purpose of funding its floating indebtedness. Under terms of the indenture by which \$300,000.00 of these bonds are to be retired annually, \$158,500.00 were purchased and cancelled during the year. 30

The trying difficulties through which the Company has passed and which are reflected below in heavy losses for the year, are explained by President Toro's letter of this date.

The statement herewith presented is a consolidated statement of this Company's business with that of its subsidiaries, all of whose stock is owned by this Company. 40

Schedule 5.

Surplus December 31, 1920, per Annual Statement\$1,959,342.92

Deduct:—

Dividend of 3% paid in scrip (Series
10) March 3, 1921 149,306.02

10\$1,810,036.90

Add:—

Capital adjustment effected through
partial re-appraisement of goodwill,
brands, etc. 1,293,400.00

.....\$3,103,436.90

Deduct:—

20 Loss for the year ending
December 31, 1921, in-
cluding writing down of
inventories\$2,392,363.00

Add:—

Interest on Bills Payable
and Scrip 171,516.36

Interest on 8% Sinking
Fund Gold Bonds 140,515.56

..... 2,704,394.92

30 Surplus December 31, 1921\$ 399,041.98

Schedule 5.

PORTO RICAN-AMERICAN TOBACCO COMPANY

CONSOLIDATED BALANCE SHEET

December 31st, 1921.

Assets:

Real Estate, Machinery, Fixtures, etc.	\$1,901,893.04	10
Leaf Tobacco, Manufactured Stock, Operating Supplies, etc.	5,115,903.29	
Accounts and Bills Receivable..	1,800,351.12	
Cash	660,092.26	
Discount and Expenses on Bonds	169,920.83	
Investment in Other Companies.	261,653.32	
Goodwill, Trademarks, etc	1,500,000.00	
Total Assets	\$11,409,813.86	20

Liabilities:

Capital Stock outstanding	\$6,270,150.00	
Scrip redeemable in Capital Stock	44,079.00	
Scrip, Series No. 10	149,026.50	
Ten Year 8% Sinking Fund Gold Bonds	2,841,500.00	
Accounts and Bills Payable	1,046,654.22	
Reserved for Depreciation	659,362.16	30
Total Liabilities	\$11,010,771.88	

Surplus December 31st, 1921	\$ 399,041.98
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Respectfully submitted,

A. H. NOBLE, *Treasurer*

*Schedule 6.***Schedule 6.****PORTO RICAN-AMERICAN TOBACCO COMPANY****ANNUAL REPORT**

Fiscal Year Ended December 31st, 1920.

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Jersey City, N. J., February 15th, 1921.

Treasurer's Report to the Stockholders of

Porto Rican-American Tobacco Company of New Jersey.

The Treasurer respectfully submits the following financial report of your Company for the year ended December 31st, 1920.

20 There has been no change in the amount of authorized Capital Stock during the year though additional stock of the par value of \$3,600.00 was issued in exchange for fractional certificates surrendered, making the amount outstanding at the end of the year \$4,965,350.00.

The statement herewith presented is a consolidated statement of this Company's business with that of its subsidiaries, all of whose stock is owned by this Company.

The Net Profits for the year, after deducting all charges and expenses of operations, and providing for income and excess profits

30 taxes, were\$ 998,947.97
 Surplus December 31st, 1919 1,557,619.05

\$2,556,567.02

Deduct:—

Four Quarterly Dividends of 3% each
 paid in Scrip 597,224.10

Surplus December 31st, 1920\$1,959,342.92

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Schedule 6.

PORTO RICAN-AMERICAN TOBACCO COMPANY
OF NEW JERSEY AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET

December 31st, 1920.

Assets:

Real Estate, Machinery, Fix- tures, etc.	\$1,896,680.29	10
Leaf Tobacco, Manufactured Stock, Operating Supplies, etc.	7,355,811.21	
Accounts and Bills Receivable..	2,570,723.28	
Cash	839,892.72	
Stocks in Other Companies	281,652.32	
Goodwill, Trademarks, etc.	206,600.00	

Total Assets	\$13,151,359.82	20
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Liabilities:

Capital Stock Outstanding....	\$4,965,350.00	
Fractional Certificates and Scrip redeemable in Capital Stock..	11,517.50	
Scrip, Series No. 1 to No. 9 in- clusive	1,343,754.24	
Accounts and Bills Payable....	4,145,070.36	
Reserve Funds	726,324.80	

Total Liabilities	\$11,192,016.90	30
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Surplus December 31st, 1920	\$ 1,959,342.92	
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Respectfully submitted,

A. H. NOBLE, *Treasurer*

Memorandum Opinion of Vice-Chancellor.

IN CHANCERY OF NEW JERSEY.

10	<i>Between</i> PHILIP M. GRAUSMAN, <i>Complainant,</i> <i>and</i> PORTO RICAN - AMERICAN TOBACCO COMPANY, <i>Defendant.</i>	} <i>On Bill, &c.</i>
20	<i>Between</i> WILLIAM R. HOCHSTER, <i>et al.</i>, <i>Complainants,</i> <i>and</i> PORTO RICAN - AMERICAN TOBACCO COMPANY, <i>Defendant.</i>	} <i>On Rules to Show Cause.</i>

July 6, 1923.

Appearances:

30 McCarter & English, Esq's, for complainant, Philip M. Grausman.

Merritt Lane, Esq., for complainants Hochster, *et al.*

Lindabury, Depue & Faulks, Esq's, for the defendant.

MEMORANDUM OF OPINION.

BENTLEY, V.-C.:

These two cases were, by stipulation, argued together. The bill in each instance is filed by a stockholder to enjoin the defendant from holding a stockholders' meeting for

Memorandum Opinion of Vice-Chancellor.

the purpose of issuing additional capital stock and was heard on bill and affidavits.

The company was incorporated in 1899 for the purpose of manufacturing and selling tobacco and tobacco products, with an authorized capital stock of \$5,000,000, subsequently increased to \$10,000,000, divided into 100,000 shares, par value \$100 each, of which 62,816 $\frac{1}{2}$ shares are now outstanding, all of which are common stock. In addition the defendant controls, through the ownership of their stock, three subsidiary corporations and is the most important Porto Rican tobacco industry and one of the largest manufacturers of cigars in the United States. It had been exceedingly prosperous until the year 1921 when, through labor troubles, it was obliged to suspend business for about nine months of that year and thereby it has been financially embarrassed. Not only has it lost money by reason of inability to use high-priced stock which it already had on hand but during the time that it was unable to fill orders the demand for its products has fallen off so that it now finds itself in a position where it requires \$1,500,000 for the purchase of supplies, principally a stock of tobacco of the present crop, and in conducting an advertising campaign to reinstate its products in their former popularity. It is impracticable for it to borrow because of a bond issue secured by a mortgage which has exhausted its credit in that direction.

To meet this situation, it was proposed to issue, share for share with the existing common stock, a new issue of stock without par value, to be sold to the Tobacco Products Corporation for the price of \$25. per share, up to the number of shares of common stock then outstanding; whereupon a resolution was adopted, pursuant to the statute, to call a stockholders' meeting for that purpose, and it was provided that all of the existing stock be changed into a like number of shares of 7% cumulative preferred stock of the par value of \$100 which should be entitled to receive each year a cumulative 7% dividend

Memorandum Opinion of Vice-Chancellor.

before the new or non-par stock should be permitted to participate in the profits and then the latter class of stock to receive a dividend of \$7 per share per year and thereafter each share of stock of either class should participate equally in the further profits, and that upon dissolution the preferred stock should be redeemed at par, with accumulated dividends if any, and that thereafter the assets remaining should be divided ratably among the holders of the non-par stock. Upon receiving notice of such intended plan, the complainants secured orders to show cause, with *ad interim* restraint, whereupon the plan was abandoned.

On May 3, 1923, or less than two months thereafter, a new plan to finance the company was proposed by the board of directors, and this is the plan that is under consideration in these cases. A resolution was passed whereby it was recited that it was advisable to amend the certificate of incorporation of the defendant so that the present authorized capital stock of 100,000 shares of the par value of \$100 per share, designated for convenience as "class A common stock" be supplemented by an issue of 100,000 shares of "class B common stock" without nominal or par value and without voting power, "which the board of directors may issue in their discretion, in whole or in part, to the holders of "class A common stock" as a stock dividend or offer to them the right to subscribe for the same or otherwise dispose of in accordance with law." It then went on to recite that the class A stock should first be entitled to a cumulative dividend of 7% and that thereafter there should next be paid out of the profits a dividend of \$7 per share per annum on class B common stock and that thereafter all additional profits should be equally divided between class A stock and class B stock, share and share alike, and that upon dissolution of the corporation class A should be redeemed at par if possible and all excess, if any, be distributed ratably

Memorandum Opinion of Vice-Chancellor.

among the holders of both classes; and then went on to describe, that in the issuing of any additional class A stock the holders of class B should have no preferential right to receive or subscribe to the same, and that in the event of any new class other than those just considered being authorized not only should the consent of two-thirds of class A be necessary but as well two-thirds of class B. 10

It is then charged that such a plan is *ultra vires* and is against the objection of stockholders; that it would change the fundamental arrangement of the corporation and violate rights of the stockholders, because the issuing of no-par-value stock was not permitted at the time of the incorporation of the defendant; that it confiscates the property rights of the stockholders in the corporation; that it is a fraud upon the State to obtain an illegal change in its stock issue; and that the officers of the corporation have secured proxies of a sufficient number of the stockholders to accomplish the plan they design to effectuate. 20

The corporation, as has been said, was organized in 1899 or more than 20 years before the legislative authority for the issuing of stock without any stated par value (Pamphlet Laws 1920, 336). The main point made by the complainants is, that under the authority of *Allen v. Francisco Sugar Co.* (92 N. J. Eq., 431), decided in this court by Vice-Chancellor Fielder and affirmed by the Court of Errors and Appeals, there is no legal warrant for the issuing of such a class of stock. In that case it was proposed by the Sugar Company to execute a lease for "practically all its revenue-producing property" to another corporation, and the rationale of the decision was that there having been no legislative sanction therefor at the time of its incorporation it could take no advantage of a permissive act passed a short time thereafter, for the reason that it would impair the obligations of the contract into which the shareholders entered at the 30 40

Memorandum Opinion of Vice-Chancellor.

time of the company's incorporation. It seems clear to me that the reasoning in the Allen case is not apposite to the determination of the question presented here. In all of the authorities relied upon in the case of Allen v. Francisco Sugar Company (*supra*), both in this court and in the Court of Errors and Appeals, there was involved the question of the right of a corporation to dispose of practically all its property without legislative sanction against the objection of one or more of its shareholders. Of course, it is clear that this would work such a change in the original agreement of the stockholders as to disturb their vested rights and require unanimous consent of every individual concerned, no matter how small his holding might be (Kean v. Johnson, 9 N. J. Eq., 401; Black v. Delaware & Raritan Canal Co., 24 N. J. Eq., 455; Mills v. Central R. R. Co., 41 N. J. Eq., 1).

The main question presented here is, whether or not the issue of stock without stated par value by the defendant would be such a change in the fundamental contract of the stockholders as to come within the rule expressed in those and other cases. If it would, then it is clear that it would violate the Constitution of the United States (Art. 1, Sec. 10). If, on the other hand, it merely points out a different method of accomplishing the same result, by recourse to subsequent legislation, as might have been effected at the time of the incorporation of the company, no illegality will attach to the desired action.

No-par-value stock is, of course, a creature of recent origin, and no direct authority has been brought to my attention, of any jurisdiction, that will assist in resolving the question here under consideration. In Alabama, the Supreme Court has recently decided the case of Randle v. Winona Coal Co. (89 So., 790; 19 A. L. R., 118). That case turned chiefly upon a comparison of the act with constitutional provisions peculiar to the State of Alabama, from which no assistance is to be had in determining the

Memorandum Opinion of Vice-Chancellor.

question presented in this case. It was pointed out in that opinion, that although twenty-one states had adopted no-par stock legislation within a few years, it is an unimportant consideration in the decision of a constitutional question. However, it needs no argument or citation of authorities to prove that there is a disinclination to disturb legislative enactments unless their conflict with the organic law is apparent. It does seem to me, however, that the needs of commerce, as evidenced by the rapid adoption of the no-par stock idea, is something that may properly be taken into account unless it is clear that it does contravene the constitution, not in some fanciful or farfetched manner but substantially and in real effect. The decision of the main question presented here may have a tremendous influence upon the fortunes of innumerable investors. Such consideration, however, I am conscious, must always be subordinate to the supreme law that is the foundation upon which our entire legal system is erected.

At the time of the defendant's incorporation the pertinent provision of the corporation act provided as follows:

Every corporation organized under this act may change the nature of its business, change its name, *increase its capital stock*, decrease its capital stock, *change the par value of the shares of its capital stock*, change the location of its principal office in this state, extend its corporate existence, *create one or more classes of preferred stock*, and make such other amendment, change or alteration as may be desired, in manner following:

Thus the law stood for the purpose of this case until the enactment of the so-called no-par-value-stock act, which was a supplement to the corporation act (Pamphlet Laws 1920, 336, amended Pamphlet Laws 1921, 833).

The reasoning of the complainants is that under *Allen v. Francisco Sugar Co.* and the other cases cited above, re-

Memorandum Opinion of Vice-Chancellor.

course may not be had to the act of 1921, but that changes in the capitalization of the company can only be accomplished by means allowed at the time of incorporation. The change desired by the defendant does not seem to me of such a fundamental character as to make the Allen case applicable. At the time this company was
10 organized, it will have been observed, it was within the power of the statutory majority to increase its capital stock. It was also, under the act, permissible to change the par value of the shares. In substance and effect, this is precisely what was contemplated at the time these bills were filed. It is to be borne in mind that, in the judgment of the directors and a vast majority of stockholders no practical method of meeting the emergency with which they were faced was available except by an increase of its capital stock. Clearly, had it been desired
20 the company could have reduced the value of its shares to the sum of \$25 each and thereupon have increased its common stock by the issue and sale of an additional 100,000 shares. In the scheme under consideration the same result is to be effected by increasing the capital stock, declaring no expressed value of the shares upon the certificates of stock, and selling the same for \$25 per share in the manner provided by law. In the case of *Berger v. U. S. Steel Corporation* (63 N. J. Eq., 809), it will be recalled that it was proposed to retire 2,000,000
30 shares of preferred stock and pay for the same out of bonds or the proceeds thereof, at a lower rate of interest than the cumulative dividend of the preferred stock, the particular shares to be retired being 40% of the respective holdings of the preferred stockholders. This was determined by the Court of Errors and Appeals not to be in derogation of any of the vested rights of such stockholders. Mr. Justice Van Syckel, at page 812, said:

In the presence of the fact that over ninety-nine per cent. of all the stockholders in attendance at the meeting, personally or by proxy, voted in favor
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Memorandum Opinion of Vice-Chancellor.

of the resolution, it cannot reasonably be expected that the court is impressed with the belief that the complainant will suffer any substantial injury by the consummation of the scheme. Nevertheless, if it appears that the proposed action is without legal authority, the complainant cannot be denied the relief which she seeks, but, in passing upon this controversy, the greatest care must be observed that this overwhelming majority of the stockholders are not deprived of their rights by the very few dissentients. 10

And in this connection it is significant, though not controlling, that the interest of the protesting stockholders is an exceedingly small percentage. I say "not controlling," because if their contention be sound the holder of a single share has a standing to prevent the attempted *ultra vires* act of his corporation. (Chicago City Railway v. Allerton, 18 Wall. 233.) In the Berger case the retirement of the preferred stock was justified under an act passed in 1902, or one year after the incorporation of the United States Steel Corporation. Two objections were made to this by the complainant, first, that the act was special, and, secondly, that it impaired the right of the complainant, vested prior to the passage of the act. In discussing the latter question the opinion concedes that the fifth section of the corporation act as it now exists (the reserve power to amend, alter or repeal charters), only applies to questions between the corporation and the state, but that the rights of stockholders, *inter sese*, cannot be so impaired except, of course, so far as impairment may be incidental to the interest of the public. It says: 20 30

It is difficult to perceive how any substantial force can be accorded to it, unless some amendment may be made which may affect the rights of stockholders *inter sese* to some extent.

In regard to what may or may not amount to a substantial interference with private rights he says:

It is unnecessary, however, to determine, in this case, what the true limitation upon the legislative 40

Memorandum Opinion of Vice-Chancellor.

power is; where the boundary line is which cannot be overstepped.

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Such a declaration in this case would be *obiter* and unwise. The law upon this subject, which is of great moment, is, as yet, in a formative state; a general rule upon a subject of so wide a range can be implanted in our jurisprudence only by gradual development, as questions arise for adjudication.

Vice in a legislaive act cannot safely be predicated upon the mere fact that it may not be unreasonable to apprehend that some depreciation in the value of shares may flow from it. The legislature may impose additional burdens; it may withdraw the right to engage in some remunerative branch of business, and may repeal the entire charter.

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Undoubtedly there may be changes so radical that underlying and fundamental principles will not permit the legislature to reserve to itself a right to make them.

* * * * *

30

The act of 1896 gave the appellant the right, by a two-thirds vote of its shareholders, to retire preferred stock by purchase; the act of 1902 preserves that right, merely regulating the manner in which it should be exercised. As before stated, the complainant held her stock subject to the right of the company to retire, by purchase, the shares of such stockholders as might desire to sell, and the act of 1902 in no respect alters or changes her position except to make it more secure when the given option is refused by her. No right which vested under the Corporation act of 1896 is impaired or taken away by the later statute.

Just so in the case *sub judice*. The complainants, having in contemplation at the time of their contracts the same changes that are now to be effected in the capitalization of the company, are in no wise injured by reason of the method pursued being different from the procedure permitted at that time.

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Memorandum Opinion of Vice-Chancellor.

Similarly, the other objections by the stockholders as to the effect of the change in capitalization, are without substance. For example, the effect upon the dividend and distributive values of the shares and right of class B to vote as to the creation of any new class of stock might have been accomplished by a similar method that has been referred to, namely, the reduction of the par value of the existing capital stock and then the issue of an additional 100,000 shares. 10

The case of *Einstein v. Raritan Woolen Mills* (74 N. J. Eq., 624) stands upon a very different footing, the defendant having been incorporated by a special act of the legislature which therein limited by express terms the capitalization to \$250,000. Subsequently, it was proposed to increase the capitalization to \$525,000. Such a plan, in the face of the instrument of its birth requires no argument to show it was a vastly different and more injurious proceeding than the increase of capitalization in the case at bar, supported by legislative sanction as there is, for the reason I have already given. 20

In the next place, it is urged that the resolution under discussion, if adopted by two-thirds of the stockholders, would result in changing the existing common stock into preferred stock. It is clear, from an examination of the statute already quoted, that if this be so it is a fatal defect. (*Einstein v. Raritan Woolen Mills, supra.*) So far as I know or have been able to learn, no comprehensive definition has ever been attempted of "preferred stock." Counsel have cited text and cases to the effect that the adjective prefixed to "stock" means nothing, and that the question is one of contract, to be gathered from all the surrounding circumstances, such as the statute, the certificate of incorporation, the resolution of the board, &c. To assure to holders of a class of stock a certain minimum return upon their investment does not, of itself I think, so change the character of the shares as to present 30 40

Memorandum Opinion of Vice-Chancellor.

the vice protested by the complainants. An attempt, under guise of such a benefit, to deprive the owners of such shares of a fundamental and vital privilege would, of course, present an insuperable objection. No such attempt is here to be observed. It is not intended to take from the holders of existing stock the right of suffrage except incidentally, as might have been done under the original statute. It is not proposed to interfere with their dividend rights, subject to the same qualification, or the distribution of the assets, or in any other way.

The remaining objection of the complainants to be dealt with is their complaint that the present stockholders are to be deprived of their right to purchase each his *pro rata* share of the new stock if and when issued. An examination of the resolution to be submitted to the stockholders, I think, disposes of this objection. It is true that in March of the present year there was proposed a similar issue of stock to the one under consideration, that was to be disposed of to an independent company known as "The Tobacco Products Company," without first being offered to the stockholders in the manner required by law. That plan, as I have already said, upon being challenged by the filing of a bill or bills by stockholders, was abandoned because the iniquity of the scheme had only to be stated to convince the directors. The resolution of May 3, 1922, to be voted upon by the stockholders, on the other hand, provides that "the board of directors may issue, in their discretion, in whole or in part, to the holders of class A common stock as a stock dividend, or offer to them the right to subscribe for the same, or otherwise dispose of in accordance with law." So far as the first two discretionary powers are concerned, there can be no quarrel. Objection, however, is made to the clause "or otherwise dispose of in accordance with law." Of course, this entire opinion is predicated upon the disposition of the new shares as required by the rule laid down in *Wall v.*

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Utah Copper Company (70 N. J. Eq., 17); *Morganstern v. American Smelting Co.* (57 N. J. Eq., 358), and *Way v. American Grease Co.* (60 N. J. Eq., 263). The right of the present stockholders to have first call upon the new stock cannot be defeated by any corrupt or other plan of the directors. The resolution distinctly says that it must be disposed of in accordance with law, and not only is there nothing in the proofs to indicate that it will not be so disposed of, but, in addition thereto, any such attempt can be promptly and efficiently controlled. I intimated upon the argument, merely as an argument, that the complainants might say that in view of the unlawful resolution of March, a just suspicion might attach to the resolution of May; but, on the other hand, it is equally reasonable to think that the error of the company having once been pointed out to it there would be no subsequent attempt to deprive the present stockholders of the right in this connection. But be that as it may, there is nothing to warrant the belief that the directors will deliberately fly in the face of the law, and if they do, there will then be a sufficient remedy. If the new issue were beyond the power of the corporation, then it would undoubtedly be true, as complainants say, that they could not be compelled to spend one penny in protecting rights that were being illegally affected. However, in *Berger v. U. S. Steel Corporation* (page 815) it is said:

Equality and the equitable right of shareholders to uniform treatment is preserved by giving the like option to all.

So here, the no-par-value act of 1921, being applicable, as I have already shown, the present stockholders cannot object to the increased issue where, equally, in proportion to their holdings, they are protected against any advantage being taken of them. Otherwise, any corporation finding itself in the financial emergency that faces this one could be wrecked by any individual having an

Memorandum Opinion of Vice-Chancellor.

interest therein, however small, to the destruction of the fortunes of all his associates and irrespective of his motives in making his attack.

I will advise an order denying the preliminary injunction sought and dissolving the existing restraint.

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Order Denying Injunction.

ORDER DENYING INJUNCTION.

Entered July 9, 1923.

IN CHANCERY OF NEW JERSEY.

Between

PHILIP M. GRAUSMAN,

Complainant,

and

PORTO RICAN-AMERICAN TOBACCO COMPANY,

Defendant.

On Bill, &c.

*On Rule to
Show Cause.*

10

This cause coming on to be heard on a rule to show cause heretofore allowed why a preliminary injunction should not issue; and the bill of complaint and the affidavits annexed thereto and the affidavits presented by the defendant having been read and considered, and counsel having been heard with respect to said application and due consideration having been given to the same,

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It Is now, on this 9th day of July, 1923, ORDERED, ADJUDGED AND DECREED that the said rule to show cause be dismissed and the injunction so as aforesaid applied for refused, with costs to be taxed.

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E. R. WALKER,

C.

Respectfully advised,

JOHN BENTLEY,

V.-C.

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*Order Denying Injunction.***ORDER DENYING INJUNCTION.**

Entered July 9, 1923.

IN CHANCERY OF NEW JERSEY.

10	<i>Between</i> WILLIAM RICE HOCHSTER, <i>et als.</i> , <i>Complainants,</i> <i>and</i> PORTO RICAN-AMERICAN TOBACCO COM- PANY, <i>Defendant.</i>	}	<i>On Bill, &c.</i> <i>On Rule to</i> <i>Show Cause.</i>
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20 This cause coming on to be heard on a rule to show cause heretofore allowed why a preliminary injunction should not issue; and the bill of complaint and the affidavits annexed thereto and the affidavits presented by the defendant having been read and considered, and counsel having been heard with respect to said application and due consideration having been given to the same,

It Is now, on this 9th day of July, 1923, ORDERED, ADJUDGED AND DECREED that the said rule to show cause be dismissed and the injunction so as aforesaid applied for refused, with costs to be taxed.

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E. R. WALKER,

C.

Respectfully advised,

 JOHN BENTLEY,
 V.-C.

Notice of Appeal (Grausman).

NOTICE OF APPEAL.

Filed.

IN CHANCERY OF NEW JERSEY.

Between

PHILIP M. GRAUSMAN,

Complainant,

and

PORTO RICAN-AMERICAN TOBACCO COM-
PANY,

Defendant.

On Bill, &c.

*Notice of
Appeal.*

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The complainant hereby appeals from the order made in this cause on the 9th day of July, 1923, and from the whole and every part thereof to the Court of Errors and Appeals in the last resort in all causes.

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McCARTER & ENGLISH,

Solicitors for and of Counsel with Complainant.

I conceive there is good cause for appeal in the above-stated cause.

CONOVER ENGLISH,

Of Counsel with Complainant.

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Petition of Appeal (Grausman).

PETITION OF APPEAL.

Filed.

New Jersey Court of Errors and Appeals

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Between

PHILIP GRAUSMAN,

Complainant-Appellant,

and

PORTO RICAN-AMERICAN TOBACCO COM-
PANY,

Defendant-Appellee.

On Bill, &c.

*On Appeal from
Court of
Chancery.*

*Petition of
Appeal.*

20 *To the Honorable, The Court of Errors and Appeals in
the last resort in all causes:*

30 The petition of Philip Grausman, the appellant in the
above-stated cause, respectfully shows that your petitioner
finds himself aggrieved by an order made in the Court
of Chancery by his Honor Edwin Robert Walker, Chan-
cellor of the State of New Jersey, bearing date the 9th
day of July, 1923, in a suit wherein the said Philip Graus-
man is the complainant and the said Porto Rican-Ameri-
can Tobacco Company was defendant, in this respect, to
wit: that the said order adjudges and decrees that the
rule to show cause made in this matter on May 29th, 1923,
be discharged and that the preliminary injunction prayed
in the bill of complaint be denied; and your petitioner
humbly appeals from the said order of the Chancellor
made on July 9th, 1923, as aforesaid upon the ground
that the same was erroneous for that the said order
should not have discharged the rule to show cause and
should have adjudged and decreed that a preliminary
injunction issue in accordance with the prayer of the bill.

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Petition of Appeal (Grausman).

Your petitioner therefore prays that the said order of the said Chancellor may be reversed, set aside and for nothing holden and that your petitioner may have such other relief in the premises as to this Honorable Court may seem meet.

McCARTER & ENGLISH,
Solicitors for and of Counsel with Appellant. 10

CONOVER ENGLISH,
Of Counsel with Appellant.

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Answer to Petition of Appeal (Grausman).

ANSWER TO PETITION OF APPEAL.

Filed August 17, 1923.

NEW JERSEY COURT OF ERRORS AND APPEALS.

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Between

PHILIP M. GRAUSMAN,
Complainant-Appellant,
and

PORTO RICAN-AMERICAN TOBACCO COM-
PANY,
Defendant-Respondent.

On Bill, &c.

*On Appeal from
Court of
Chancery.*

*Answer to
Petition of
Appeal.*

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The answer of the above-named respondent, to the petition of appeal of the above-named appellant.

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This respondent, not acknowledging all or any of the matters which in the said petition of appeal are contained to be true, for answer thereto, nevertheless, says and admits, that an order was on the ninth day of July, 1923, made and entered in the Court of Chancery in the cause for that purpose mentioned in the said petition, as is therein stated; but as to the substance and form thereof, this respondent prays to refer thereto when the same shall be produced. And this respondent is advised and believes, that the said order is agreeable to equity and it prays that the same may be affirmed with costs to be adjudged to this respondent.

LINDABURY, DEPUE & FAULKS,

*Solicitors for and of Counsel
with Defendant-Respondent.*

Filed Aug. 17, 1923.

THOMAS F. MARTIN,
Clerk.

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A true copy
THOMAS F. MARTIN,
Clerk.

Notice of Appeal (Hochster, et al.).

NOTICE OF APPEAL.

Filed.

IN CHANCERY OF NEW JERSEY.

Between

WILLIAM R. HOCHSTER, *et al.*,

Complainants,

and

PORTO RICAN-AMERICAN TOBACCO COM-
PANY,

Defendants.

On Bill, &c.

*Notice of
Appeal.*

10

The complainants hereby appeal from the whole and every part of the order made in this court, in the above-entitled cause, bearing date July 9th, 1923, to the Court of Errors and Appeals in the last resort in all causes.

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Dated, July 9th, 1923.

MERRITT LANE,

Solicitor and of Counsel with Complainants.

I conceive there is good cause for appeal in the above-stated cause.

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MERRITT LANE,

Of Counsel with Complainants.

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Petition of Appeal (Hochster, et al.).

PETITION OF APPEAL.

Filed.

NEW JERSEY COURT OF ERRORS AND APPEALS.

10	<i>Between</i> WILLIAM RICE HOCHSTER, <i>et al.</i>, <i>Complainants-Appellants,</i> <i>and</i> PORTO RICAN-AMERICAN TOBACCO COM- PANY, <i>Defendant-Respondent.</i>	<i>Petition of Appeal.</i>
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20 *To the Honorable, The Court of Errors and Appeals in the
last resort in all causes:*

30 The humble petition of William Rice Hochster, Margaret R. Thompson, W. Roosevelt Thompson and Alice Moffitt Pulleyn, the appellants in the above-stated cause, respectfully show that your petitioners find themselves aggrieved by an order made in the Court of Chancery by his Honor, Edwin Robert Walker, Chancellor of New Jersey, on the 9th day of July, 1923, in a cause wherein the said William Rice Hochster, Margaret R. Thompson, W. Roosevelt Thompson and Alice Moffitt Pulleyn were complainants and the Porto Rican-American Tobacco Company was defendant, in this respect, to wit, that the said order directs that the application of the complainants for temporary restraint or for a temporary injunction be denied with costs. And your petitioners humbly appeal from the whole of said order aforesaid upon the ground that the same is erroneous for that the said Court of Chancery should have restrained the defendant, until the final hearing in this cause and its several stockholders and their several attorneys, agents and proxies from

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Petition of Appeal (Hochster, et al.).

voting in favor of the proposed amendment to the certificate of incorporation of the defendant company, pursuant to the resolution of the board of directors of the corporation dated May 3rd, 1923, and from signing any assent to any such amendment and from taking any action whatever upon said proposed amendment either at the meeting of stockholders on May 31st, 1923, or at any continuation or adjournment thereof, and from in any wise taking any steps to put in effect the plan set forth in the bill of complaint upon the ground that the corporation was not authorized to amend its certificate of incorporation in accordance with the proposed plan, and for the purpose of providing for the issuance of stock as therein provided; and because the said proposed plan and the issuance of said stock would violate the substantial rights of the present stockholders creating a fundamental change in the relation of the stockholders which it was illegal to attempt, and as against the present stockholders of the corporation, of which the appellants are some, under the non-par stock act of 1920 as amended, said act having been passed subsequent to the incorporation of said defendant; and because the effect of the said plan would be to change the stock of appellants, which is common stock, into a preferred stock in violation of the rights of appellants; and because the said plan contemplated the issuance of a greater proportion of preferred stock than is permitted by law; and because the said plan reserved to preferred stock a greater dividend than is permitted by law; and because the right given by said plan to the holders of Class B stock to vote upon the issuance of new stock is in violation of law; and because the said plan did not properly provide for the right of subscription of appellants; and because the said plan contemplated that the directors of the corporation should be given the right to sell the said non-par stock at such price and at such times as they might see fit, and this power was proposed to be vested in the directors by an amendment to the

Petition of Appeal (Hochster, et al.).

certificate of incorporation in violation of the statute; and because the said plan upon the whole was illegal as to the appellants and could not be put in force without violating the legal and equitable rights of appellants.

10 Your petitioners therefore pray that the said order of the said Chancellor may be, in the particulars aforesaid, reversed, set aside and for nothing holden, and that your petitioners may have such relief in the premises as to this Honorable Court shall seem meet.

MERRITT LANE,
Solicitor and of Counsel with Appellants.

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Answer to Petition of Appeal (Hochster, et al.).

ANSWER TO PETITION OF APPEAL.

Filed.

NEW JERSEY COURT OF ERRORS AND APPEALS.

<i>Between</i>	<i>On Bill, &c.</i>	10
WILLIAM RICE HOCHSTER, et al.,	<i>On Appeal from Court of Chancery.</i>	
Complainants-Appellants,		
and		
PORTO RICAN-AMERICAN TOBACCO COM- PANY,	<i>Answer to Petition of Appeal.</i>	
Defendant-Respondent.		

The answer of the above-named respondent, to the petition of appeal of the above-named appellants. 20

This respondent, not acknowledging all or any of the matters which in the said petition of appeal are contained to be true, for answer thereto, nevertheless, says and admits, that an order was on the ninth day of July, 1923, made and entered in the Court of Chancery in the cause for that purpose mentioned in the said petition, as is therein stated; but as to the substance and form thereof, this respondent prays to refer thereto when the same shall be produced. And this respondent is advised and believes, that the said order is agreeable to equity and it prays that the same may be affirmed with costs to be adjudged to this respondent. 30

LINDABURY, DEPUE & FAULKS,
*Solicitors for and of Counsel
with Defendant-Respondent.*

Consent is being given to the filing of the within answer as of time.

M. L.
Attorney of Appellant 40

New Jersey Court of Errors and Appeals

Between

PHILIP M. GRAUSMAN,
Complainant-Appellant,

and

PORTO RICAN-AMERICAN TOBACCO
COMPANY,
Defendant-Respondent.

On Bill, &c.

*On Appeal
from Order
Denying
Injunction.*

Between

WILLIAM RICE HOCHSTER, *et al.*,
Complainants-Appellants,

and

PORTO RICAN-AMERICAN TOBACCO
COMPANY,
Defendant-Respondent.

BRIEF FOR COMPLAINANTS-APPELLANTS.

These two cases come here on appeals from orders advised by Vice-Chancellor Bentley denying a preliminary injunction in each case. The two cases were argued together and involve the same state of facts and the same questions of law.

Complainants are stockholders and the two suits represent an aggregate of 1,069 shares of stock, or \$106,900 par value (p. 1, l. 36; p. 56, ll. 5 to 15).

The bills were filed to enjoin the tobacco company from submitting to a stockholders' meeting and the stockholders from acting upon, a resolution of the directors dated May 10, 1923, providing for an amendment to the certificate of incorporation.

The company has at present an authorized capital of \$10,000,000, divided into 100,000 shares of the par value of \$100 each; 62,816½ shares are issued and outstanding. All of the stock is common stock.

The resolution complained of reads as follows (p. 49, l. 32):

“RESOLVED: That it is advisable and for the best interest of the company to so amend the certificate of incorporation and increase its capital stock as that:

(1) In addition to the present authorized capital stock of 100,000 shares of the par value of \$100 per share, all of one class (hereinafter referred to as Class A common stock only for the purpose of differentiating it in these resolutions from the proposed new common stock denominated Class B common stock), there be authorized an issue of 100,000 shares of Class B common stock, without nominal or par value and without voting power, which the Board of Directors may issue in their discretion in whole or in part to the holders of Class A common stock as a stock dividend; or offer to them the right to subscribe for same, or otherwise dispose of in accordance with law. Said Class B common stock shall enjoy the privileges and be subject to the further following restrictions and conditions:

(a) That when and not until cumulative dividends of seven per cent. shall have been paid upon Class A common stock there may be paid dividends in the aggregate equal to \$7.00 per share on Class B common stock for the fiscal year. As to all further dividends that may be declared for the fiscal year, Class A common stock and Class B common stock shall share equally, share and share alike.

(b) Upon dissolution of the corporation, or upon final distribution of its assets, and after the payment of its debts, Class A common stock shall be redeemed at par with accumulated dividends, if any, if the assets of the corporation, including surplus and accumulated profits, are sufficient; if the assets are not sufficient, then all said assets or their proceeds shall be distributed rat-

ably among the holders of Class A common stock. If the assets are more than sufficient for such redemption, all remaining thereafter shall be distributed ratably amongst the holders of said two classes of common stock.

(2) The Board of Directors may issue any authorized and unissued Class A common stock and Class B common stock, or either, at such times, respectively, and on such terms as in its discretion may seem best and in accordance with law, and upon issuance of Class A common stock the holders of Class B common stock shall not have any preferential right to receive or subscribe for the same.

(3) In order that any other class of stock may be authorized, not only the consent of those holding two-thirds of the issued and outstanding shares of Class A common stock shall be given, but as well the consent of those holding two-thirds of the issued and outstanding Class B common stock."

The resolution then provides for the calling of a special meeting to take action and provides further (p. 51, l. 24):

"FURTHER RESOLVED: That in the event of the certificate of incorporation being amended and the capital of the corporation increased as hereinabove provided, the Board of Directors be empowered to forthwith give to the holders of Class A common stock the privilege of subscribing and taking one share of Class B common stock for each share of Class A common stock held by them respectively, in consideration of \$25.00 per share."

This resolution was the second one which the directors had proposed to the stockholders. The first one was attacked in the Court of Chancery and subsequently abandoned. It appears as Schedule "C" (pp. 44 to 46). The resolution of May 10, 1923, is very evidently an attempt to accomplish in a little different manner what it was found impossible to accomplish originally.

On the filing of the bills, orders to show cause with *ad interim* restraint were allowed. After argument the

Vice-Chancellor dismissed the orders but allowed a stay pending the hearing of the appeals, and this stay was continued by this Court.

The tobacco company was incorporated in 1899 and has paid dividends of varying amounts, the highest in any one year being 84%. Dividends were paid sometimes in cash and sometimes in scrip, which was afterwards redeemed, the average being about 20% a year. In 1920 the company encountered labor troubles which so seriously affected its earnings, that it was required to float a bond issue of \$3,000,000. Following the settlement of the strike, prosperity began to return to the company, so much so that the bond issue has been reduced to about \$2,250,000 (p. 4, l. 20).

The treasurer in his report for the year ending December 31, 1922, said that "results from operations during the latter part of the year were very satisfactory" (p. 42, l. 26) "although not sufficient to off-set the losses from operations earlier in the year."

The president, in a letter to the stockholders, dated February 21, 1923, commented on this report, in cheerful vein, and said (p. 54, l. 17):

"While the treasurer's report shows losses of \$390,238.41, after depreciation of inventories, your company has been operating at a profit since October 1, 1922, and every indication points to bigger and better business for the year 1923.

Profits from operations during the last quarter, before depreciation, have been about \$150,000, and there is every reason to believe your company will show substantial profits in 1923."

Contrast this with the gloomy statement in his affidavit filed in answer to the bill (p. 82, l. 11). He says nothing in his affidavit of the profit of \$150,000, nor prospects of bigger and better business.

On the contrary he claims in his affidavit that those expectations have not been realized (p. 87, l. 23). It is significant, however, that the answering affidavits do not disclose any figures beyond March 31, 1923 (p. 84, l. 26;

p. 96, l. 26). The affidavits were verified on June 20, 1923, but no figures later than March 31, 1923, were disclosed, nor did the company on resisting the application for a stay made in this Court on September 14th, disclose to the Court its financial condition later than March 31, 1923, although crying poverty at that time.

The gist of the defense set up in the answering affidavits is that the company needs \$1,500,000 to properly conduct its business and that the scheme proposed in the resolution of May 10, 1923, is necessary to raise this money, and that it is *legally justifiable* on the ground that an equal or greater damage might have been done the complainants' interest had the company proceeded according to the law as it was in 1899.

The bills of complaint attack the amendment proposed in the resolution of May 10, 1923, on the ground that it changes the fundamental contract between the stockholders and the corporation, is *ultra vires* and is inequitable.

The specific grounds of this attack will be considered under separate points.

I.

The resolution illegally attempts to create an issue of no par value stock.

The defendant company was incorporated in 1899. At that time the act concerning corporations (P. L. 1896, p. 277, provided, by Section 27 (p. 285), as follows:

"27. Every corporation organized under this act may change the nature of its business, change its name, increase its capital stock, decrease its capital stock, change the par value of the shares of its capital stock, change the location of its principal office in this state, extend its corporate existence, *create one or more classes of preferred stock*, and make such other amendment, change or alteration as may be desired, in manner following:" * * *

That remained the statutory law until long after the incorporation of the company.

The present statute authorizing the creation of no par value stock was not enacted until 1920 (P. L. 1920, p. 336, Ch. 168; amended P. L. 1921, p. 833, Ch. 284).

There is no authority outside of these statutes for the creation of no par value stock. The effort, therefore, is to apply the authority of the amendment to this corporation in the face of the objection of the dissenting stockholders.

Such an effort is squarely against the principal announced by this Court in *Allen v. Francisco Sugar Co.*, 92 N. J. Equity 431, reported below 92 N. J. Equity 391.

In that case the company had been incorporated in 1899. About a month after its incorporation the statute was passed permitting a corporation to lease its property and franchises. The defendant corporation proposed to make a lease to a Cuban corporation of all its lands and personal property (p. 392). The views of the Vice-Chancellor were stated by him as follows at page 393:

“The power to give a lease to another corporation was not a lawful act which the corporation might undertake at the time of its incorporation, and therefore such power could not have been in the minds of the incorporators or included within the objects set forth in their certificate. This statute is merely the consent of the state that the stockholders may do the thing therein provided for, but it cannot alter the contract as between the stockholders themselves, or as between the stockholders and the company, unless all agree to accept the act as a modification or amendment to their charter. *Einstein v. Raritan Woolen Mills*, 74 N. J. Eq. 624; *Colgate v. United States Leather Co.*, *supra*.”

This Court by Justice Kalisch upheld the conclusion of the Vice-Chancellor. In his opinion Justice Kalisch said, with respect to the act authorizing the lease (p. 433):

“The learned Vice-Chancellor further held that the act was inapplicable because it did not come into existence until a month after the organization of

the appellant company so that it alters a contract between the stockholders.

It is clear from the decisions of our courts that before the passage of the statute the transaction contemplated to be transacted by the appellant company could not have been lawfully accomplished without the consent of all the stockholders. The complainant, in the present case, is the dissenting stockholder. The principle referred to is first clearly and forceably enunciated in a very able and learned opinion of Cortlandt Parker, embraced in a report made by him as master in chancery, in *Kean v. Johnson, et al.*, 1 Stock. 401, at which page the first two headnotes express the legal rule applicable to the present case.

'Where a board of directors, or a majority of stockholders deviate from the originally contemplated undertaking the "rights" of other and dissenting stockholders are "affected," as against them they cannot legally do it.'

'A majority of stockholders in a prosperous corporation cannot, at their own mere caprice, sell out the whole source of their emoluments and invest their capital in other enterprises, where the minority desire the prosecution of the business in which they had engaged. The contract is that their joint funds shall, under the care of specified persons, generally called directors, be employed, and that for certain specified purposes.' This case was decided in 1853.

The doctrine proclaimed in that case was followed by a long line of cases which are cited in the opinion of the court below."

The Court then cited *Black v. Delaware & Raritan Canal Co.*, 24 N. J. Equity 455, and *Mills v. Central R. R. Co.*, 41 N. J. Equity 1. The Court then continued (p. 434):

"The doctrine, recognized by the cases cited, springs from the organic law which forbids the legislature from passing any law impairing the obligations of contract, or depriving a party of any remedy for enforcing a contract which existed at the time the contract was made."

It was contended by the defendant in the *Allen* case that because the complainant had acquired his stock

after the passage of the leasing act he was to be considered as a stockholder whose rights were fixed by statute at the time he bought his stock. This contention was overruled as an attempt to formulate a rule which would tend to inextricable confusion (p. 435).

The rights of the complaining stockholders, therefore, are fixed as of the date of the incorporation of the company.

In *Meredith v. Zinc & Iron Company*, 55 N. J. Equity, affirmed 56 N. J. Equity 454, Vice-Chancellor Pitney said (p. 218):

“It is conceded on all hands that the original certificate of organization of this company forms a contract between the several stockholders, which, except by unanimous consent, cannot be affected by any change in it made by virtue of any subsequent act of the legislature, but that it can only be effectually changed by virtue of some act of the legislature then in force, which can and should be, so to speak, read into the contract.”

The fact that the corporation act provides that it may be amended or repealed at the pleasure of the legislature and that every corporation created under the act shall be bound by such amendment, does not aid the defendant. This reservation in the statute has been made by the State for its own benefit, and has been construed not to affect or change the rights of corporators as between each other.

This Court in the Allen case, 92 N. J. Equity 431, page 435, said:

“Nor does it authorize the state to authorize one part of the stockholders, for their own benefit, at their mere option, to change their contract with the other part; and that the power is restrained to the powers and franchises granted by the charter. It does not authorize the legislature to change the object of the incorporation, or to substitute another for it. An alteration or modification is necessarily of the grant or thing to be altered or modified

and cannot be done by substituting a different thing. Chief Justice Beasley, in *New Jersey Midland Railroad Co. v. Strait*, 35 N. J. Law (at p. 325), speaks approvingly of the doctrine above enunciated. And this court, speaking through Mr. Justice Van Syckel, in *Berger v. United States Steel Corporation*, 33 N. J. Eq. (at p. 824) says: 'It must be conceded that it is firmly settled in our jurisprudence that the rights reserved in this sixth section to amend, alter or repeal charters extends only to the modification or destruction of rights as between the state and the corporation, but that the rights of the stockholders *inter sese* can in no respect be impaired, except in so far as impairment may result from an alteration required by the public interest.' "

The same view was taken by Vice-Chancellor Howell in *Einstein v. Raritan Mills*, where he said (74 N. J. Eq. 624, p. 629):

"I must hold that this act is merely the consent of the state that the stockholders may, if they all agree, do the things which are provided for in that act. But if all the stockholders do not agree, the act cannot be held to be a portion of the charter of the corporation or an amendment thereto. This is specifically held in *Kean v. Johnson*, 9 N. J. Eq. (1 Stock.) 417; *Zabriskie v. Hackensack Railroad Co.*, 18 N. J. Eq. (3 C. E. Gr.) 178; *Black v. United Railroad and Canal Companies*, 24 N. J. Eq. (9 C. E. Gr.) 455; *Mills v. New Jersey Central Railroad Co.*, 41 N. J. Eq. (14 Stew.) 1, and many other cases which have engrafted this doctrine into our law so deeply as to be beyond disturbance."

It was argued in the case at bar, and the Vice-Chancellor thought, that this case was ruled by *Berger v. United States Steel Corporation*, 63 N. J. Equity 809, rather than by the *Allen* case.

This Court in the *Berger* case, however, found it unnecessary to determine what the true limitation upon the legislative power was under the general grant of power

to make alterations. In its opinion this Court said (63 N. J. Equity, at p. 827):

“Under the General Corporation act of 1896, there is a general grant of power to make alterations without words of limitation, and the provision is declared to be part of the charter of every corporation organized under it.

It is unnecessary, however, to determine, in this case, what the true limitation upon the legislative power is; where the boundary line is which cannot be overstepped.”

There is no basis found in the Berger case for the argument which was advanced below that in view of the broad powers of amendment which existed at the time the defendant was incorporated the act permitting the issuance of no par stock effected no fundamental change in the contract between the stockholders and the corporation. This Court in the more recent Allen case, specifically limited the power of amendment to those cases where the rights of stockholders *inter sese* could in no respect be impaired.

The resolution which was the subject of attack in the Berger case was upheld, because it was found that it worked perfect equality among the stockholders. This Court expressly found that “there has been no act of preference on the part of the corporation” (63 N. J. Eq., at p. 819).

So, *Farmers' Loan & Trust Company v. Hewitt*, 118 Atlantic 267, relied on by the defendant below, is not in point. The defendant there attempted nothing contrary to law. That was conceded by the complainant. Vice-Chancellor Backes, says at page 269:

“Statutory authority for raising the funds by bonds convertible into stock, as undertaken by the directors, is conceded, and that the procedure is in all respects in conformity with sections 27 and 29a of the Corporation act (2 Comp. St. 1910, pp. 1612, 1616) is not disputed, but the complainants set up a variety of reasons why the court should intervene.”

The defendant company in the Hewitt case sought to issue bonds convertible into stock in strict conformity with Section 27 of the Corporation act (P. L. 1902, p. 217). The company had been incorporated after the enactment of that statute. There was no question of its legal right. The only question was whether it was inequitable to permit it to assert this legal right under the circumstances of that case. Both the Court below and this Court held that it was not inequitable.

How can this case be distinguished in principle from the Allen case? In that case this Court held that the after-enacted Leasing act did not validate the lease made by the company which had been incorporated before the statute was enacted. Here, the effort is to apply the after-enacted no par value stock act to a company which was incorporated before that statute was enacted. This Court refused to permit the lease to be made in the Allen case because it found that to do so would impair the fundamental contract between the stockholders and the company. Equally, here, the carrying out of the scheme proposed in the resolution will impair the fundamental contract between the stockholders and the company. The principal which governs the one case governs the other.

In the case at bar not only does the resolution of May 10th propose to change the fundamental contract between the parties, but provides for an inequitable distribution of the new stock, an inequitable distribution of dividends, and an inequitable division of the property in case of dissolution, as will be hereinafter pointed out.

II.

The resolution illegally attempts to change the existing common stock into preferred stock.

The previous plan, which was abandoned by the defendant, frankly endeavored to compel the common stockholders to surrender their stock in exchange for preferred stock.

The present plan, while it retains the existing common stock under the name of common stock, in effect, turns it into preferred stock.

It is elementary that equity looks at the substance and not at the form. If, therefore, as a matter of fact, the present scheme does in effect make the existing common stock a preferred stock, it should be enjoined.

There was no authority in the statute at the time of the incorporation of the company to change common stock into preferred stock.

While the resolution refers to the existing stock as Class A common stock, it is in reality preferred stock.

The mere name of "common" or "preferred" means nothing. The answer to the question depends upon the construction to be given the contract between the stockholder and the corporation. This contract consists of the statute, charter and the stock certificate.

See Thompson on corporations, Vol. 4, 3604.

In *Lloyd v. Penn. Electric Vehicle Co.*, 75 N. J. Equity 263, the question, as stated by Justice Swayze in this court, was (p. 264):

"The question to be decided is one of contract, and the contract of the preferred and common stockholders *inter sese* is determined by the provisions of the statute and of the certificate of incorporation."

He then said on p. 265:

"It has been held, and may be regarded as entirely settled, that calling stock 'Preferred stock' does not of itself determine the rights of the holders, for the extent of the preference is to be determined

by the terms of the contract. *McGregor v. Home Insurance Co.*, 33 N. J. Eq. (6 Stew.) 181; *Elkins v. Camden and Atlantic Railroad Co.*, 36 N. J. Eq. (9 Stew.) 233."

See also *McGregor v. Home Ins. Co.*, 33 N. J. Eq. 181.

In *Elkins v. Camden and Atlantic R. R. Co.*, 36 N. J. Equity 233, Vice-Chancellor Van Fleet said (p. 236):

"There are certain legal principles pertinent to this discussion which I think are so firmly established that they may be taken for granted without argument or the citation of authorities. * * * third, calling stock preferred stock does not, *per se*, define the rights of such stock, but in order to determine in what respect the holder of such stock is to be preferred to the holder of ordinary stock, resort must be had to the statute or contract under which it is issued; and, fourth, where the statute or contract under which preferred stock is issued, declares or promises that the holder of such stock shall receive a dividend of a fixed and certain rate per annum, without limiting the annual sum to be paid as dividend to profits earned or made within a designated period—as, for example, that he shall receive a dividend of seven per cent. per annum before any dividend shall be paid on the ordinary stock—there the preferred stockholder is entitled to seven per cent. per annum from the date of the issuing of the stock held by him, whether profits sufficient to pay him each year are made or not; and if, at the first division of profits, sufficient shall not have been made to pay him the whole sum due, he may carry the arrears due him over to the next dividend, and continue to do so until he has received the whole sum due him, calculated at seven per cent. per annum from the date of the issue of the stock held by him. The principle last stated rests mainly on English adjudications, and has in that country received the approval of such judges as Lord Cranworth, Lord Hatherly, Lord Justice Knight Bruce and Lord Justice Turner."

He then cites a series of English cases and points out that they were all approved in *Boardman v. L. S. & M. S. R. R. Co.*, 84 New York 157 (237).

See also *Heller v. National Marine Bank*, 43 Atl. 800 (Court of Appeals of Maryland), where the Court said:

“The mere naming of it does not make it that which it is named, if, in fact, it is something else. Its properties and qualities determine what it is. If the statute calls it what its properties and qualities show it is not, surely it does not thereby become what it is misnamed, and cease to be what it essentially is. Calling stock preferred stock does not *per se* define the rights in such stock, but these depend on the statute or contract under which it was issued. *Elkins v. Railroad Co.*, 36 N. J. Eq. 233. As said by the Supreme Court of Ohio: ‘To call a thing a wrong name does not change its nature.’”

Reference to the resolution of May 10th, 1923, shows that if the scheme goes through, the existing stock will be a preferred stock in everything but name. The new stock will likewise be a preferred stock, and there will be no common stock at all.

The present stock has a right to share in *all* the business and profits of the company. It is proposed to change it into stock which is limited, in the first instance, to a 7% preferred dividend, and, in case of dissolution, is limited, in the first instance, to *redemption* at par. Where the word “redemption” is used it is always applicable to preferred stock. Who ever heard of redeeming common stock? What is this so-called common stock Class A, after the plan shall have been carried through, if it is not preferred stock?

It has been specifically held that under the corporation act of 1896, as it existed at the time of the incorporation of this company, common stock cannot be changed into preferred stock against the will of a dissenting stockholder; so held in *Einstein v. Raritan Woolen Mills*, 74 N. J. Eq. 624.

In that case, the company had \$150,000 common stock issued and outstanding. The proposal was to increase the stock to \$525,000 of which \$150,000 should be pre-

ferred, and the remainder common, and further, for the existing common stock to be converted into preferred. Vice-Chancellor Howell held that was *ultra vires*, as violating the contract between the company and its stockholders.

After citing the cases of *Chicago City Railway v. Allerton*, 18 Wall. (U. S.) 233, *Scoville v. Thayer*, 105 U. S. 143, *Bank v. Railroad Co.*, 13 N. Y. 599, *Railroad Company v. Schuyler*, 34 N. Y. 30 and *Kent v. Quicksilver Mining Co.*, 78 N. Y. 182, the Vice-Chancellor said (p. 627):

"The reasoning of these cases goes to the question of the violation of the contract as alleged by the complainant, and it applies to the other matters mentioned in the resolution, namely: the creation of preferred stock and the compelling of the present shareholders to surrender their common stock and accept preferred stock in lieu thereof."

He said further (p. 628):

"All the other provisions of our statutes relating to the creation of preferred stock have been passed since the Raritan Woolen Mills was organized as a corporation, and it not appearing in the case that these subsequent provisions have been accepted by the shareholders as amendments to the charter, I feel obliged to hold that there is no authority for the creation of preferred stock without the consent of every shareholder. The same line of argument applies to the attempt of the directors to convert the present common stock into preferred stock. It is said on behalf of the company and its directors that the complainant cannot be compelled to convert its own stock into preferred stock, and that he therefore need not do it; that he may continue to hold it as common stock and that inasmuch as one share of stock is like another, it can make no difference to him whether he holds his shares which have been heretofore authorized or whether he holds shares which shall be authorized by virtue of the resolution in question. The reasoning of Mr. Justice Bradley in the Allerton Case above cited seems conclusive on this point. He says: 'Second, as it respects the constituency or capital and membership. This is the next most important fundamental

point in the constitution of a body corporate; to change it without the consent of the stockholders would be to make them members of an association in which they never consented to become such. It would change the relative influence, control and profit of each member; even when the additional stock is distributed to each stockholder *pro rata* it would often work injustice, because some of the stockholders might be unable to take their respective shares and might thus lose their relative interest and influence in the corporate concerns.' I take it that when Mr. Justice Bradley speaks of the consent of the stockholders he means the consent of every shareholder, and that a mere majority, however large, would not have the power to interfere with the rights and property of the minority."

The Vice-Chancellor attempted to distinguish the Einstein case (p. 181, l. 12) from the case at bar, on the ground that the defendant there had been incorporated by a special Act which limited the capitalization to \$250,000.

While that is true, the decision does not depend on that ground. Suppose the proposal had been to change the whole or a part of the authorized capital common stock into preferred stock, could the decision have been any different?

The fundamental legal principle upon which the Einstein case was decided applies equally to the case at bar.

The same principle underlies the decision of Vice-Chancellor Emery in *Pronick v. Spirits Distributing Co.*, 58 N. J. Equity 97, where the effort was to reduce the dividend on complainant's preferred stock. The Vice-Chancellor held (p. 100) that "such alteration would impair the obligation of the contract created by the stock certificates issued under the Company's Charter."

III.

The scheme proposed in the resolution of May 10, 1923, is illegal and inequitable because it deprives the existing common stockholders of their legitimate share of dividends earned and of assets upon dissolution.

As the corporation is now organized, the existing stockholders are entitled to *all* of the dividends and *all* of the assets on dissolution, after payment of debts.

The company has had its financial ups and downs. In some years it has brought large returns to its stockholders. In other years none. It has averaged, however, about 20%. The existing stockholders have borne the burden of the last several years, when no dividends were earned, and now, that the prospects of the company are brighter, it is proposed to deprive them of the profits which would otherwise be theirs. Under the scheme of the resolution of May 10th, the existing stockholders are deprived of their present unlimited right to dividends and also their present unlimited right to the distribution of all the assets on dissolution. It is not the *quantum* of dividends or assets which a stockholder may receive which determines the fairness of an amendment. It is rather the equality of distribution as between all the stockholders of the same class. The present proposed scheme violates this rule of equality.

If preferred stock were issued, according to law, ahead of the existing common, under the statute as it was at the time of the incorporation, that would not only be in accordance with the contract between the stockholder and the company, but would leave the existing common stockholders to receive all the dividends over and above the preferred dividends, and all the assets on dissolution over and above that sufficient to pay the preferred stock. The present scheme does not work that way.

The vice in the resolution as applied to the equity of the case, lies in the fact that the distribution of dividends and the distribution on dissolution is *on a per share basis*.

The existing common stock when turned into preferred, will receive \$7.00 per share dividends. The no par stock is also to receive \$7.00 per share.

The existing stockholder had to pay \$100.00 for his share. The no par stockholders may acquire their stock at varying prices. The resolution, which is permissive, but not mandatory (p. 51, l. 27) empowers the Board of Directors to sell the Class B common stock at \$25 per share. The proposed amendment, however, leaves it entirely in the discretion of the directors to dispose of the Class B stock. At what price will they dispose of it? It may be \$25 a share. It may be no more than \$10 a share. The distribution of dividends as provided for, is, therefore, manifestly unequal. The existing common stockholders paid \$100 a share. On that investment they receive a return of 7% or \$7.00. The no par stockholder may have paid \$25 or \$10 or \$1 on which he will receive a dividend of \$7.00 based on a per share basis and not on the price at which he paid. If the no par stockholder bought his stock at \$25 he would receive dividends to the amount of \$28.00 on a \$100 investment, whereas the existing common stockholder would receive but \$7.00 on a \$100 investment. The ratio would depend on the price which the no par stockholder paid, but always to the disadvantage of the existing common stockholder.

Counsel argued below that the old stock under the plan is entitled to share *pro rata* in all dividends declared after both classes of stock have received dividends of seven dollars per share. But by the plan that seven dollars a share upon the new stock is taken away from, and is at the expense of, the present stock.

It is true that seven dollars per share might be taken from the present stock by the corporation issuing preferred stock, *but if that were done the present stockholders would know that for every share of preferred stock that was issued the company's assets would be increased by \$100 whereas, under the present plan the stockholders do not know at what price the non par stock will*

be sold, but they do know that at whatever price it is sold and whatever amount is received by the corporation it receives a dividend of seven dollars per share.

So, on the distribution of the assets after dissolution, the assets are to be distributed "ratably amongst the holders of said two classes of common stock." "Ratably" must mean on a per share basis, and not in proportion to the amounts paid. It is conceivable, therefore, that a \$100.00 share of existing stock would receive no larger proportion than a share of no par value stock, for which the owner paid \$10.00. Manifestly, the distribution of assets is unequal. Upon dissolution, whatever price they may have been sold at, the no par shares, after the present common stock has received par, share equally with the present common.

IV.

The scheme proposed in the resolution of May 10, 1923, is illegal and inequitable because it deprives the existing common stockholders of their right to purchase their *pro rata* share of new stock.

The Vice-Chancellor conceded (p. 182, l. 38) as do counsel for the defendant, that the existing stockholders have the first right to purchase their *pro rata share* of any new stock.

Way v. American Grease Co., 60 N. J. Equity 263, p. 269;

Wall v. Utah Copper Co., 70 N. J. Equity 17;

Morganstern v. American Smelting Co., 57 N. J. Equity 358.

Is this right to the existing stockholders preserved?

The resolution leaves it to the discretion of the directors to dispose of the Class B stock by

(1) offering it in whole or in part to the holders of Class A stock as a stock dividend; or

(2) offering to Class A stock the right to subscribe for same; or

(3) "otherwise dispose of it in accordance with law"

(p. 50, l. 10).

(1) If it is true, as the president of the defendant states, in his letter to the stockholders dated May 10, 1923, that "the entire surplus of the company has been consumed" (p. 53, l. 10) there is no possibility of a distribution of Class B stock as a stock dividend. That disposition of the stock is, therefore, eliminated.

(2) An offer to the existing stockholders to subscribe for Class B stock would not necessarily in itself protect them. Note that it is in the power of the board to do this in their discretion. They may never make the offer. But, assuming that they do, there is no rule of law or equity which will compel the present stockholders to protect themselves by such purchase unless the corporation has the legal right as against the present stockholders to do the thing which it proposes to do.

In the Einstein case (74 N. J. Eq. at p. 628) Vice-Chancellor Howell quotes Justice Bradley in *Chicago City Railway Co. v Allerton*, 18 Wall. 233, as saying:

"Second, as it respects the constituency or capital and membership. This is the next most important fundamental point in the constitution of a body corporate; to change it without the consent of the stockholders would be to make them members of an association in which they never consented to become such. It would change the relative influence control and profit of each member; even when the additional stock is distributed to each stockholder *pro rata* it would often work injustice, because some of the stockholders might be unable to take their respective shares and might thus lose their relative interest and influence in the corporate concerns."

To enforce a rule that the existing stockholders are compelled to purchase new stock to protect themselves

would result in this: that it is a perfect answer to any complaint against an illegal act proposed by a corporation that the persons injured may protect themselves by the expenditure of money.

But the stockholders here are not in a position to protect themselves even by the expenditure of money. Suppose the complainant does take his proportion of the new no par stock and suppose certain other stockholders do not take their proportion. This leaves certain of this no par stock which may be disposed of by the directors at such times and at such prices and to whom the directors may see fit. The directors may therefore, after the complainant has been obliged in order to protect himself, to purchase this no par stock at twenty-five per share, offer other of this no par stock at ten. And in that event the no par stock purchased at ten will not only share with the common stock of the present stockholders, now possessed by them, share for share in the manner and to the extent provided for by the plan, but this latter issue of no par stock at ten will also share, share for share, and equally in all respects, with the no par stock which the complainants have been forced to purchase to protect their interests at twenty-five.

Far, therefore, from the complainants being in a position to protect themselves by a purchase of this no par stock at twenty-five, if they *do* purchase no par stock at twenty-five they are in danger, *through the expenditure of their own moneys*, of placing themselves in a position where they may be further injured.

(3) The directors may "otherwise dispose of" Class B stock "in accordance with law."

What does that mean?

Who is to be the judge of what is in accordance with law?

Such a resolution places it within the power of the directors to dispose of the stock against the rights of and to the disadvantage of the existing stockholders,

and leaves them to the necessity of instituting further suits to establish that the directors have not disposed of it "in accordance with law."

The Vice-Chancellor seemed to think (p. 183) that if the directors attempted to do this there would be a sufficient remedy. Perhaps there would, but the existing stockholders ought not to be subjected to that hazard. The present application, so far as it affects this phase of the case, is in the nature of a *quia timet*.

The original scheme proposed by the resolutions of March 22, 1923 (Schedule "C") (p. 44) as interpreted by the president in his letter of the same date (p. 48) frankly provided for the sale of 64,566 shares of the no par stock to the Tobacco Products Corporation at \$25 per share.

Is it conceivable that the Tobacco Products Corporation, which was willing to spend over \$1,500,000 in the purchase of no par stock of the defendant, has abandoned that idea, and that the provision in the resolution to otherwise dispose of the stocks in accordance with law, is as innocent as the Vice-Chancellor thought it was?

V.

Paragraph (2) of the resolution of May 10, 1923, illegally empowers the directors to dispose of the no par stock on such terms and under such conditions as they deem proper.

That part of the resolution reads as follows (p. 50, l. 33):

"(2) The Board of Directors may issue any authorized and unissued Class A common stock and Class B common stock, or either, at such times, respectively, and on such terms as in its discretion may seem best and in accordance with law, and upon issuance of Class A common stock the holders of Class B common stock shall not have any preferential right to receive or subscribe for the same."

By the terms of this resolution the directors are given the absolute power to dispose of this no par stock at such prices and at any time and under whatever conditions they may deem proper. This means that the no par stock may be sold at ten or five or at any price.

The purpose of the resolution is, of course, to bring the case within the 2nd section of the no par stock act, which provides that the corporation may issue and may sell its shares "for such consideration as may be prescribed in the certificate of incorporation or any amendment thereof or if so provided *in the certificate of incorporation*, as from time to time may be fixed by the board of directors," and the purpose is to avoid that provision of the statute which requires that, if no such provision is made in the certificate of incorporation, the price at which the stock is to be sold must be fixed "with the consent of two-thirds of each class of the stockholders having voting power" given at a meeting called for that purpose. This right to sell stock *at any price* at which the directors may choose to sell it, of course, is a substantial change in the rights of the stockholders. *Under legislation existing at the time of the incorporation of this company the price at which the directors might sell the stock was fixed by statute, to wit, par.*

There was no right in the directors to sell for less than that. Now, under the no par stock act it is provided that the directors may sell the stock from time to time at such price as they may fix. A more complete and substantial change cannot be imagined, and resort cannot be had by the defendant, therefore, to the provisions of the no par stock act.

But even if resort could be had to its provisions the statute makes a distinction between the certificate of incorporation and the amendment thereof.

It provides that the corporation may sell its no par stock "for such consideration as may be prescribed in the certificate of incorporation or any amendment there-

of." Under this clause of the statute the corporation may fix in the certificate of incorporation, or amendment of the certificate of incorporation, the price at which this no par stock may be issued.

But when it comes to permitting the directors to fix the price the provision of the statute is "*or, if so provided in the certificate of incorporation, as from time to time may be fixed by the board of directors.*"

In this clause the statute omits the words used in the preceding clause "*or any amendment thereof.*"

The result of this is that it is only in case the *original* certificate of incorporation contains a provision giving the board of directors power to sell the stock from time to time at such price as they may fix, that the directors may so act.

The present plan is to permit the incorporation of that provision into the certificate *by amendment.*

There is a logical reason for this difference in the legislation.

If a stockholder buys into a corporation incorporated with a certificate which provides that the directors may fix the price at which the no par stock may be sold from time to time he does it with his eyes open.

If a stockholder buys into a corporation which has no such provision then he knows that, before the no par stock can be sold, the price at which it may be sold must *be fixed by two-thirds of the stockholders having voting power.*

It is, therefore, a substantial change in his rights to permit an amendment to the certificate of incorporation which will deprive the stockholders of this right given to them and vest the power in the board of directors.

Not only, therefore, is there a very apparent difference in *the language* used by the legislature with respect to the two things, but there is a substantial reason behind the difference.

Nor are the stockholders under the provisions of this resolution proposed given the absolute right to subscribe to this no par stock. The provision of the resolution, if it be the fact, which is not clear, that it is proposed that the last resolution be submitted to the stockholders, is that the board of directors "be *empowered* to forthwith give to the holders of Class A, etc." There is no provision commanding the board of directors so to do.

VI.

The proposed scheme cannot be justified as practically possible under legislation existing at the time of the incorporation. It is a substantial change in the rights of stockholders. The no par stock is a reversal of legislative policy.

The Vice-Chancellor held that the Allen case (92 N. J. Equity 431) was not applicable (p. 178, l. 10), because at the time the company was organized it was within the power of the statutory majority to increase its capital stock or to change the par value of the shares. He said (p. 178, l. 14):

"in substance and effect this is precisely what was contemplated at the time these Bills were filed."

The Vice-Chancellor adopted the argument of the defendant below, which in effect did not attempt to justify the legality of the proposed scheme, but urged that it should not be restrained because the corporation could accomplish the same result in a legal manner.

It is conceded on all hands that notwithstanding the reserved power of amendment, subsequent legislation cannot authorize a change in the substantial rights of stockholders.

The defendant argued below, however, that Section 120 of the No Par Act (P. L. 1921, p. 833) applies here because by its terms it applies to every corporation organized or thereafter to be organized under the corporation act.

This language, however, is no stronger than the Leasing Act, which was the subject of construction in the Allen case. The language of the Leasing Act (P. L. 1899, p. 334, Section 133, Pamphlet Ed. General Corporation Act) provides that any corporation of this state may hereafter, with the assent of two-thirds of the stockholders, lease its property and franchises to any corporation.

Is it any stronger to say:—"every corporation organized, or hereafter to be organized under the corporation act" than it is to say "Any corporation of this state?" If anything, the phrase "Any corporation of this state" is stronger than the phrase "Every corporation organized or hereafter to be organized under this act." The Leasing Act, by its terms, would apply to any corporation of New Jersey organized under the general corporation act, or other statute, while the no par stock act is limited by its terms to a corporation organized under the general corporation act. Therefore, if the Leasing Act was not sufficient to authorize the making of a lease by a corporation which had been incorporated before this enactment, much less does the no par stock act enable a corporation which was organized before its enactment, to issue no par stock.

Defendant concedes, that back in 1899, corporations had no right to issue no par stock. To argue that the same result, or an equally injurious one, could be accomplished then, as is sought to be accomplished in the case at bar now, amounts, when analyzed, to an admission of the illegality of the present plan and an attempted justification upon the ground that the same result could be accomplished in a legal way.

But it is not true that the same result could be accomplished under legislation existing at the time of the incorporation of this company in a legal way.

That the change in the relative rights of the stockholders contemplated by the proposed scheme is substantial there can be no question.

At the present time the common stockholders are entitled to *all* of the profits of the company and to *all* of the property of the company, and they are entitled to have it divided among them in proportion to the moneys which they have invested in the company because all of the stock was issued at the time when no corporation could issue its stock for less than par, and it is a conclusive presumption that par was paid to the corporation for all the stock.

The substantial rights of the stockholders now are, therefore, two in number; first, to have all of the profits and assets of the company, and second, to have the assets distributed among the present stockholders upon the basis of the moneys which were paid to the corporation for the stock, to wit, par under the law.

There is, therefore, at present absolute equality *based upon money paid*. If the proposed plan be put through the present stockholders will, in the first instance, out of dividends, be limited to seven per cent.; there then will be paid seven dollars per share upon each share of the new no par stock, and if there be any remaining profits they are to be distributed upon the basis of an equal amount per share upon the old stock and the new no par stock.

When it comes to a distribution of assets the present stock is entitled, in the first instance, to par. If the assets are more than sufficient to pay par or "sufficient for such redemption," to use the language of the resolution, "all remaining thereafter shall be distributed ratably amongst the holders of said two classes of common stock." In other words, the new no par stock will share, share for share, with the present common.

The mere statement of this plan shows the substantial change in the rights of the present stockholders.

That change could not have been accomplished by any legislation existing at the time of the incorporation of the company.

The powers given to a corporation with respect to changes, etc., are those prescribed by Section 27 of the Corporation Act, Revision of 1896; and Section 28. Section 28 was amended by the laws of 1898, Chapter 92, p. 149.

These sections provide that a corporation may "increase its capital stock, decrease its capital stock, change the par value of the shares of its capital stock * * * create one or more classes of preferred stock, etc."

It is said that by virtue of these provisions of the statute the corporation may decrease the par value of the shares of the present common, if it so desired, to twenty-five dollars, or to a nominal value, and that after such decrease has been put in effect, the corporation might then issue new common of the new par value which would create the inequality created by the present plan.

There are two answers to this—

First. The power to change the par value of the shares of the capital stock is a power which must be exercised in good faith, and if, as matter of fact, the present capital stock, represented value in excess of the aggregate amount to which it was proposed to decrease its par value and it was proposed to make that decrease for the purpose of issuing new common stock at the new par value to share, share for share, with the old common stock, this would be a fraud upon the act and would not be permitted for a moment.

It is not claimed that the present common stock does not represent a value in excess of \$25 per share.

So that to justify the plan proposed, under the old legislation, it would be necessary for the corporation to reduce the par of the present common stock to twenty-five dollars and then issue new common stock at twenty-five. Inasmuch as the present common stock represents a value greatly in excess of \$25 per share such a scheme would inevitably be prevented as a fraud upon the act.

But assume that it would not. Still the result which is accomplished by the present scheme could not be effectuated.

Even if a plan of this kind were carried through the new common stock *would have to be issued at par*. The stockholders would know, when they voted for such a change, that for every share of new common stock the par would be brought into the treasury.

So that while an inequality might be first created *further inequality could not be created by the directors*. Under such circumstances, the stockholders might, as a business proposition, consent to the decrease of the par of the old common stock and the issuance of new stock with a decreased par value.

But under the present plan, if the new no par stock is permitted to be issued, the no par stock may be sold by the directors *at any time at any price*. There is no assurance to the present stockholders that this new stock will be sold at twenty-five or at any other price. If the scheme goes through the no par stock may be disposed of, in the years to come, at varying prices, and common stockholders who have paid one hundred dollars a share for the present common stock may, in the future, be compelled to share with stockholders who have paid five dollars per share for the no par stock.

This condition of inequality could, under no circumstances, be created by virtue of the legislation which was in effect at the time of the incorporation of this corporation.

And it is this inequality which is the vicious thing and which changes the substantial rights of the stockholders.

When the present stockholders bought their stock they did so upon the faith of legislation which had announced a public policy for this State, as referred to in the case of *Easton National Bank v. Amer. Brick Co.*, 70 N. J. Eq. 722, and in the case of *Volney v. Nixon*, 68 N. J. Eq. 605, as one which made *void* (not voidable) all contracts made

in violation thereof, that stock of a corporation could not be issued for less than par. They bought knowing that if any stock was issued it would have to be sold at par; that for every share of new stock issued the corporation would receive a corresponding asset.

The no par stock act works a complete change in this public policy. Stock of no par value may be issued from time to time at any price and at varying prices. *There is no assurance of equality even among the holders of no par stock.* A man may pay one hundred dollars a share for no par stock today and tomorrow that same stock may be purchased for ten dollars, and when it comes to a distribution of profits or of assets the man who has paid one hundred dollars a share shares equally with the man who has paid ten dollars. There is no logical argument for this. The justice of it is sought to be sustained upon the theory that the corporation should be permitted to realize for its stock whatever it can get from time to time. But this is to disregard the relationship of stockholders in a corporation as that of partners, as, in effect, they are, and it is to disregard the fact that, although it may be that the corporation cannot realize par for its stock, nevertheless the moneys of the stockholders who have paid par have gone into the corporate enterprise.

The only possible way that a no par stock issue could be worked out with justice and equality to the stockholders would be to divide the profits and the earnings, not upon the basis of share for share, but upon the basis of the amount of moneys actually paid to the corporation for the stock. Of course, this would be a perfectly unworkable proposition.

It is not necessary, however, to condemn the idea of no par stock. It is only necessary in this case to indicate, whether it be a good or bad idea, that it works a substantial change. It is a complete reversal of policy.

Nor could, under the old legislation, the corporation, by change in its certificate of incorporation create two classes

of common stock with different preferences to each class. The power of amendment contained in Section 27 is "to increase its capital stock, decrease its capital stock, change the par value of the shares of its capital stock * * * create one or more classes of preferred stock."

While Section 18 of the act as stated in *General Investment Co. v. Bethlehem Steel Corp.*, 87 N. J. E. 234, at p. 240, gives power to create two or more kinds of stock of such class with such designations, preferences and voting power of restrictions or qualification thereof," this refers to the *original incorporation*, and we must look elsewhere for the power to change. We find the power to change in Section 27. It did *not* at the time this company was incorporated give the corporation the power by amendment "to create two or more kinds of stock, of such classes, with such designations, preferences and voting powers or restrictions or qualifications thereof as shall be stated and expressed in the certificate of incorporation or in any certificate of amendment thereof." The power of amendment was limited to *increase* or *decrease* of capital stock and *change of par value*. It was not until 1901, P. L. 1901, p. 245, after the incorporation of this company, that Section 18 was amended to read: "Every corporation organized under this act shall have power to create two or more kinds of stock, of such classes, with such designations, preferences and voting powers or restrictions or qualifications thereof as shall be stated and expressed in the certificate of incorporation, or in any certificate of amendment thereof."

As it existed at the time of the incorporation of this company Section 18 required that the classes of stock, designations, preferences and voting powers or restrictions or qualifications thereof should be stated "*and expressed in the certificate of incorporation.*" The amendment of 1901 is significant. It indicates that the legislature considered that, in order to permit a corporation, to create these different classes of stock by amendment, it

was necessary to insert in Section 18 the words: "or in any certificate of amendment thereof."

Counsel had recourse in his argument below to Section 18 but it is apparent that Section 18 cannot be used as authority for a change whatever may be its effect with respect to new corporations.

The language that the Court used, therefore, in *General Investment Co. v. Bethlehem Steel Corp.*, 81 N. J. E. 234, at page 240, is, with respect to *this* corporation, of no application whatever.

We are driven back, therefore, to Section 27, which gives authority *only* to increase or to decrease, or to change the par value, and to "create one or more classes of preferred stock."

Counsel in his brief below said: "Assuming what we believe to be indubitably true that the defendant corporation has the right to issue non-par stock which would share *pro rata* share for share as to dividends and upon dissolution with the existing stock, it cannot be doubted that it also has the right to provide for a preferential payment of dividends to the old stock so long as under no circumstances may a share of the new stock receive a larger dividend than that paid on a share of the old."

But counsel begs the point *by assuming that* under the legislation existing at the time of the incorporation of this company the company had the right to, by amendment, provide for no par stock (which is not true).

Nor under the legislation existing at the time of the incorporation of this company could common stock be issued with preferential payment of dividends to a certain class of that common stock.

The moment that a preference is given in dividends to a class of stock *that* stock, under whatever name it is called, becomes a preferred stock.

Thompson on Corporations, Vol. 4, p. 3604;

Elkins v. Camden and Atlantic R. R. Co., 36 N. J. E. 233;

Lloyd v. Penn. Electric Vehicle Co., 75 N. J. E. 263;

Heller v. National Marine Bank, Court of Appeals of Md., 43 Atl. 800.

In *General Investment Co. v. Bethlehem Steel Corp.*, 87 N. J. E. 242, relied on by defendant below, Cook, Section 12, p. 62, is referred to. Cook says with respect to the definition of common stock:

“By common stock is meant that stock which entitled the owners of it to an equal *pro rata* division of profits, if any there be; one stockholder, or class of stockholders, having no advantage, priority or preference over any other shareholder or class of stockholders in the division.”

And the Court then said:

“The legislature has provided that this common stock may be divided into any number of classes. The only distinction which I can think of must be in relation to voting rights. There may be class A voting stock, with full voting power; class B, allowing each share one-half a vote, and so on.”

Stock which has a preference either as to dividends or assets (which are material things) is therefore preferred stock.

The legislation, by Section 18 of the act of 1896, as it existed, permitted a corporation to create “two or more kinds of stock, of such classes, with such designations, preferences and voting powers, etc.,” but it also provided that at no time “should the total amount of the preferred stock exceed two-thirds of the capital stock paid in cash or property.”

Section 27 provided that by amendment a corporation might create one or more classes of *preferred stock*.

It was impossible, as the legislation existed at the time of the incorporation of this company, for a company to issue common stock with preferences with respect to dividends and distribution of assets. Such an act would be the creation of a preferred stock, and would be subject to the limitation of the provisions of the act.

But what the scheme seeks to accomplish is, in effect, to give a *first* preference with respect to dividends to the present common and a *first* preference with respect to assets to the present common, then a *second* preference with respect to dividends to the proposed no par, and then a ratable distribution share for share of any excess.

Under the legislation existing at the time this company was incorporated it would have been absolutely impossible to accomplish this result in any way or manner whatsoever.

The application of the no par stock act cannot be justified upon the theory that, while it works a substantial change in the relative rights of stockholders, the change could have been accomplished under legislation existing at the time of the incorporation of the company.

It was practically conceded upon the argument below that if the no par stock act *did* work a substantial change in the relative rights of stockholders which could not have been accomplished under legislation existing at the time of the incorporation it could not be applied to the existing stockholders. But whether conceded or not the law is clear.

Allen v. The Francisco Sugar Co., 92 N. J. E. 431. Reported below 92 N. J. E. 291;

Black v. Delaware & Raritan Canal Co., 24 N. J. E. 455;

Einstein v. Raritan Woolen Mills, 74 N. J. E. 624;

Pronick v. Spirits Distributing Co., 58 N. J. Equity 97.

VII.

The restriction against the issuance of new stock without the consent of the holders of two-thirds of the class B stock is illegal.

The statute provides, with respect to the increase and decrease of stock, and with respect to changes and amendments in the certificate of incorporation that the change may be made—"if two-thirds in interest of each class of the stockholders *having voting powers* shall vote in favor of such amendment, change or alteration."

It is not proposed that any voting power be given to the no par stock, except the power to veto, with respect to a change in the certificate of incorporation as to the increased stock.

Counsel argued below that the class B no par stock *has* a voting power. It is submitted that it has no voting power within the meaning of the provisions of Section 27. When the statute speaks of classes of stock in Section 27 "having voting power" the statute has reference to stock which has a general voting power. It does not contemplate that there may be given to a class of stock, voting power *only* with respect to amendments. The reference is, unquestionably, to stock having a general and not a limited or a restricted voting power.

One of the great vices of the present plan is in this restricted voting power given to Class B stock. The Court will remember that the original plan was to put through a scheme under the terms of which the Tobacco Products Corporation would secure an interest in this corporation. When that plan was attacked in court it was abandoned and the present plan brought forward which we contend, is but the old plan under a new name. Defendant says that it is impossible for the Tobacco Products Corporation to secure control because, even if the Tobacco Products Company could purchase this no par stock, it has no voting power.

But it is expressly given voting power with respect to the most important matter that there is, in the present condition of this company, to wit, upon the issuance of new stock. The justification of the present plan, from the directors, is that it is impossible for this company to raise money by borrowing. The only way by which the company can obtain additional capital they say, is by the issuance of new stock, either preferred or common. If this company needs more money at some future time the Class B no par stock has an absolute right to prevent the corporation from raising money until the stockholders shall yield to the terms imposed by the holders of the Class B common stock. Unquestionably one of those terms would be an amendment of the certificate of incorporation which would *give* general voting power to the proposed no par stock.

VIII.

The plan violates the provisions of Section 18 of the Corporation Act with respect to the amount of preferred stock allowed.

Section 18 of the Corporation Act provides:

“* * * but at no time shall the total amount of the preferred *stocks* issued and outstanding exceed two-thirds of the capital stock paid for in cash or property.”

This means, if it means anything, that the preferred stocks outstanding cannot exceed two-thirds of the amount paid to the corporation, either in money or property, for all of the stock.

Assuming for the moment that the present common stock is the preferred stock and the no par stock is common stock, then upon the basis of capital “stock paid for in cash or property” the preferred stock, to wit, the present common, exceeds two-thirds of the entire amount. But counsel say that this section of the act does not apply because of the no-par stock act, which provides that

preferred stock without nominal or par value, may be issued without regard to the amount outstanding of any other class of stock. But resort cannot be had to the no-par stock act unless the effect of the no-par stock act is *not* to work a substantial change in the relative rights of stockholders, but it does work a substantial change, and therefore no resort can be had to that act.

Even with respect to this particular item the no-par stock act works a substantial change because, at the time the corporation was incorporated, preferred stocks which might be issued were limited to two-thirds of the amount of capital stock paid in in cash or in property. If that restriction be removed then preferred stocks may be issued to any amount. To say that this does not work a substantial change in the rights of stockholders is absurd. The fact that the corporation could not, under laws existing at the time of the incorporation of this company, issue preferred stock to the amount that it is contemplated to change this common stock into preferred indicates that the no-par act cannot be made to apply and the scheme must fall.

But the effect of the proposed plan is not only to make the present common preferred but it is likewise to make the proposed no-par preferred.

And the resolution contemplates *classes* of preferred. It is so stated in so many words.

After the present common has a dividend of seven per cent. then the non-par stock is given a dividend of seven dollars per share, or twenty-eight dollars on twenty-five paid in. And after that is paid, *then* the present common and the no-par share, share for share. The result of this is that the new no-par has a preference with respect to dividends. It is subject, of course, to the first preference given to the present common. But nevertheless it is a *preferred stock* and the result is that *the entire capital stock of this company is made first and second preferred with no common*, for the present par stock does not answer the definition of common. It is not stock

"having no advantage, priority or preference over any other shareholder or class of shareholders in the division."

Cook, Sec. 12, p. 62.

The result is that, not only does this corporation issue more preferred stock than is permitted by the statute, but it issues *all preferred stock with no common*. The power to do this thing was clearly not contemplated by the statute as it existed at the time of the incorporation of this company and to permit it to be done at the present time is, of course, to permit a substantial change in the relative rights of stockholders.

IX.

The dividends reserved to the stock are in violation of the provisions of the statute.

Section 18 of the act provides for dividends on preferred *stocks* not exceeding eight per cent. per annum, etc. Under the present plan, while the preferred dividend on the present common, which will become the first preferred, is limited to seven per cent., after the dividend on the no-par stock shall have been paid the present common, which will become the first preferred, will receive a further dividend.

Counsel claim that the provisions of the statute with respect to limitation of dividends on preferred stocks apply only to such dividends as may be *preferred*, but counsel does not cite, nor do I know of, any case in this jurisdiction which so holds.

Counsel further argue that the present common stockholders cannot complain of this because it is a benefit to them rather than a detriment. This might be so were it not for the fact that, if the plan goes through and this present stock is changed into a first preferred, some other stockholder of the company holding a different kind of stock may raise the question and the stock may not be

permitted to draw the dividend which it is now proposed to give it, and the result may be that the present common stockholders will not get that which they are said to be entitled to under the plan. The payment of dividends may be attacked at any time.

But further than this the no-par stock is likewise a preferred stock. For after the payment of seven per cent. on the par of the present common the no-par stock is entitled, not to unlimited dividends in participation with shares of the present common, as it would be were it in reality common stock, but to a fixed dividend of seven dollars per share and that fixed dividend is to be paid before the present common begins to share in the dividends. The result of that is that the new no-par becomes a *second preferred stock*.

If it is a second preferred stock, as, in fact, it is, then the dividend reserved to it is not fixed in the manner provided by the statute, for the statute requires, at least, that the *preference* in dividends should not exceed eight per cent. per annum. This percentage is to be figured *on par value*, and it means eight dollars on every one hundred dollars of par, but the preferred dividend on the no par stock is *not* figured in accordance with the provisions of the statute upon par, but upon shares and the dividend reserved, which is seven dollars a share, if it be assumed that the stock is to be sold, as it is proposed to be sold, at twenty-five means *preferred dividend on this stock of twenty-eight per cent.*, a clear violation of the provisions of the statute.

That the statute contemplated that there may be different classes of preferred stock, *i. e.*, a first, second or third preferred stock, is indicated by its language which is—"but at no time shall the total amount of the preferred *stocks* issued and outstanding exceed two-thirds of the capital stock, etc."

Counsel refer again to the no par act but here again counsel cannot resort to the no par act unless the no par stock act, in the particulars to which resort is had,

does not change the substantial rights of stockholders. It is quite clear that a scheme by which twenty-eight per cent. is reserved to the holders of a preferred stock is a substantial change in the rights of stockholders in view of the legislation that was in existence at the time of the incorporation of this company. By no means could this result have been accomplished under the existing legislation. Under that legislation there could be no preferred without a par value, for the limited dividends is based on a percentage of par.

X.

The fundamental contractual rights of stockholders should not be sacrificed to save a practical situation.

A reading of the Vice-Chancellor's opinion shows that in the face of defendant's claim that it needed \$1,500,000 and what the Vice-Chancellor conceived to be (p. 177, l. 12) "the needs of commerce" as evidenced by the rapid adoption of the no par stock idea, he somewhat shrank from declaring the proposed scheme illegal and void, although conceding that such practical consideration "must always be subordinate to the supreme law" (p. 177, l. 20).

In its answering affidavits, defendant claims that it needs money and that there is no other way to get it. It was urged in the court below that the court should weigh conveniences under the doctrine of *General Investment Company v. Bethlehem Steel Corporation*, 88 N. J. Equity 237 at page 244.

The cases are manifestly unlike. In the Bethlehem case, the defendant was engaged in war work, and needed money for prosecuting that work, 88 N. J. Eq. at p. 242. No other method of raising the money was suggested. In the case at bar no public interest is involved. True the company claims it needs money. The affidavit of President Toro (paragraph 22) states the financial situation as of March 31, 1923. But the affidavit was sworn to on

June 20, 1923, more than two and one-half months after March 31st. It appears that for the first quarter of 1923, the company operated at a profit, although only a small profit. The Court was not informed as to the financial progress of the company since March 31st, nor did counsel enlighten this Court any as to the financial progress of the company since March 31st, although before this Court on September 14th opposing a continuance of the stay, and at that time still crying poverty as of March 31st. It is a fair assumption that the company is justifying the prediction of its officers that it would continue to improve in 1923. (See Schedule G attached to the bill, page 54.)

The company claims it cannot sell common stock. It is curiously silent, however, on its capacity to sell preferred stock. It has a right to issue preferred stock and undoubtedly could sell it. It does not deny this. The scheme proposed, therefore, is not the only way in which the company could raise the money which it claims it needs. The status of the complainants in the case at bar is very different from what it was in the Bethlehem Steel case. Here the complainants in both suits are *bona fide* stockholders, owning an aggregate of \$100,000 of stock. In the Bethlehem suit, the Court found that the complainant was a professional agitator, and its decision was placed squarely on that ground. Vice-Chancellor Lane said (88 N. J. Eq. at p. 244):

"I prefer in this case to place my decision squarely upon the ground that a court of equity may, where application is made to it for preliminary injunctive relief by a professional agitator, weigh conveniences."

No such situation obtains here.

Wilcox v. Trenton Potteries Co., 64 N. J. Eq. 173, which was cited by defendant below, is not in point. There Vice-Chancellor Stevens pointed out that the proposed change "shall operate only upon those who consent; consequently the contract of the complainant, Wilcox, contained in his stock certificate, remains unchanged." That

case has no application to the case at bar. Here the proposed change is compulsory, and if allowed to go through, affects the rights of the stockholder against his protest.

XI.

Any supposed benefit to the complainants is no reason why injunction should not go.

If there is a benefit to the complainants if the proposed plan be carried out (which we deny) that is no reason for a denial of the preliminary injunction.

In *Elkins v. Camden and Atlantic R. R. Co.*, 36 N. J. E. 5, the Chancellor said:

“It is urged that to induce this court to interfere by injunction in such a case as this, it must appear that the complainant will, if it withholds its prohibition, sustain irreparable injury, and it is insisted that so far from being an injury to the stockholders the proposed purchase will be of very great advantage. It is also urged that the complainant is a mere volunteer; that he acquired his stock after negotiations for the purchase in question were begun, and got it for the very purpose of defeating the project. To dispose of the latter objection: It appears that the complainant is a stockholder. If, in fact, he acquired his stock at the time and with the design alleged in the answer, that would not affect his right to the relief which he seeks.

* * * * *

As to the former objection: The proceeding in question is, as before stated, strictly *ultra vires*. In such a case equity will give such appropriate relief as may be practicable against the illegal act, and that, too, at the suit of a single stockholder; while on the other hand, it will not interfere in a matter involving no breach of trust but only error of judgment on the part of the representatives of the company, even though such error may eventuate in the injury of the stockholders.”

In the case at bar we do not complain of error of judgment. We insist that as against the present stock-

holders the proposed action cannot be taken and is *ultra vires* the corporation as to them.

In *Carver v. Southern Iron and Steel Co.*, 78 N. J. E. 81, Garrison, V.-C., at page 93 said:

"It may well be that in cases where the corporation has dealt with its own directors, or with a corporation that has mutual directors, and there is a discretion in the court to affirm or disaffirm the contract when applied to by a stockholder, the court will weigh the benefits and injuries; but this cannot be applicable to a case where the thing sought to be done is contrary to the statute, is prohibited by law, and only needs the attention of the court to be called to it to cause the latter to restrain it."

There is no proof that the proposed issue of stock will work a benefit to the stockholders. Indeed, the presumptions are the other way. But to say the best for defendant, whether it will work a benefit or a detriment is so speculative that it is not safe for the court to deny the complainants' protection to their equitable rights because of a supposed benefit to be conferred upon them by the violation of their equitable rights.

Counsel says that "in no event can the old stock receive less than by way of dividends than the new."

We do not know upon what theory the statement is made.

The argument seems to be based upon the assumption that the corporation has the power to create no par stock and to place such stock on a parity with its par stock. But that is assuming in favor of the defendant one of the litigated points in the case.

XII.

The fact that the present stockholders are to be given the right to purchase the new no-par stock cannot affect the right of complainant to an injunction.

It is argued that because all of the present stockholders will be given the right to subscribe to the new no par stock that it is within their power to protect their relative interests and that, therefore, they are not injured.

Assuming (although the resolution proposed to the stockholders is permissive only) that the present stockholders are to be given the right to subscribe to the new no par stock there is no rule either of law or equity that we know of which will permit the corporation to *compel* the present stockholders to protect themselves by such a purchase unless the corporation has the legal right, as against the present stockholders, to do the thing which it proposes to do.

Any such rule would result in this: that it is a perfect answer to any complaint against an illegal act proposed by a corporation that the persons injured may protect themselves by the expenditure of money.

But the stockholders are not in a position to protect themselves even by the expenditure of money. Suppose the complainant does take his proportion of the new no par stock and suppose certain other stockholders do not take their proportion. This leaves certain of this no par stock which may be disposed of by the directors at such times and at such prices and to whom the directors may see fit. The directors may therefore, after the complainant has been obliged, in order to protect himself, to purchase this no par stock at twenty-five per share, offer this no par stock at ten. And in that event the no par stock purchased at ten will not only share with the common stock of the present stockholders, now possessed by them, share for share in the manner and to the extent provided for by the plan, but this lat-

ter issue of no par stock at ten will also share, share for share, and equally in all respects, with the no par stock which the complainants have been forced to purchase to protect their interests at twenty-five.

Far, therefore, from the complainants being in a position to protect themselves by a purchase of this no par stock at twenty-five, if they do purchase no par stock at twenty-five, they are in danger, through the expenditure of their own moneys, of placing themselves in a position where they may be further injured.

The case of *Farmers Loan and Trust Company v. Hewitt*, 118 Atl. 267, cited by counsel has no application whatever to the case at bar. In that case the corporation was proceeding in strict accord with the provisions of the Corporation Act, and it was held by the Court that its acts were in all respects legal. It was claimed in that case that, because of the peculiar circumstances there present, the right to subscribe to the new stock proposed to be issued did not adequately protect the complainant. But the Court said that, inasmuch as the proposed acts were legal and inasmuch as the corporation was proceeding strictly in accord with the statute, the complainants must be satisfied with the protection given by the law under such circumstances, which was a right to subscribe. But it was not even remotely suggested that, if the act of the corporation had been illegal and the proposed issue of stock had been illegal as against the complainant, the right of the complainant to subscribe to the illegal issue of stock would be a complete answer to the application to enjoin the illegal act.

And so in *Berger v. U. S. Steel Corporation*, 63 N. J. E. 809, in which case this Court held that the corporation was proceeding in strict accordance with the provisions of the statute, and it was for that reason that the injunction was denied.

Upon all the grounds urged it is respectfully submitted that the orders to show cause should not have been

discharged and the preliminary injunction asked for
should have been granted.

Respectfully submitted,

McCARTER & ENGLISH,
Solicitors of Complainant-Appellant,
Philip M. Grausman.

MERRITT LANE,
Solicitor of Complainant-Appellant,
William Rice Hochster.

MERRITT LANE,
CONOVER ENGLISH,
Of Counsel.

New Jersey Court of Errors and Appeals.

Between—

PHILIP M. GRAUSMAN,
Complainant-Appellant,
and

PORTO RICAN-AMERICAN TOBACCO COM-
PANY,
Defendant-Respondent.

WILLIAM RICE HOCHSTER, *et als.*,
Complainants-Appellants,
and

PORTO RICAN-AMERICAN TOBACCO COM-
PANY,
Defendant-Respondent.

On Bill, etc.

On Appeal from the
Court of Chancery.

BRIEF OF
RESPONDENT.

Statement of Facts.

The respective appeals in these cases are from decrees of the Court of Chancery denying a preliminary injunction. The Bills of Complaint were filed to restrain the respondent from submitting to its stockholders for their approval a proposed amendment to its charter providing for an increase of its capital stock. The cases were argued together under a stipulation of counsel before Vice Chancellor Bentley on June 22, 1923. The Vice Chancellor advised an order discharging the preliminary restraint and denying a preliminary injunction.

His opinion appears on pages 172 *et seq.* of the case.

The respondent company has at present an authorized capital of \$10,000,000, divided into 100,000 shares of the par value of \$100 each, of which 62,816½ shares are issued and outstanding. The proposed amendment to the charter as appears from a resolution adopted by the Board of Directors on May 3, 1923, authorizes an issue of 100,000 additional shares of stock to be known as Class B common stock without nominal or par value and without voting power. The resolution provides that after cumulative dividends of 7% shall have been paid upon the existing common stock which is designated therein as Class A common stock, dividends may be paid in the aggregate equal to \$7 per share on the new Class B common stock for the fiscal year; that as to all further dividends which may be declared for the fiscal year Class A common stock and Class B common stock shall share equally. Upon the dissolution of the corporation or upon final distribution of the assets Class A common stock shall be entitled to par with cumulative dividends, if any, if the assets of the corporation, after payment of debts, shall be sufficient. If the assets shall be more than sufficient for such purpose all assets remaining thereafter shall be distributed ratably among the holders of such two classes of common stock (Case, p. 162, line 23 *et seq.*).

The resolution further provides that in the event of the amendment of the Certificate of Incorporation as proposed the Board of Directors shall be empowered to forthwith give to the holders of Class A common stock the privilege of subscribing for and taking one share of Class B common stock for each share of Class A common stock held by them respectively for the consideration of \$25 per share (Case, p. 164, line 10 *et seq.*).

The answering affidavits made by Luis Toro, President, Harry Catlin, Secretary and Assistant Treasurer, Thomas C. Breen, Auditor and a Director, Frederick L. Kenney, Vice President and a Director, and Ambrose H. Burroughs, a Director of the respondent company, show that the company, because of severe losses sustained in previous years has an imperative need for at least \$1,500,000 of new capital (Case, p. 84, line 28 *et seq.*; p. 95, line 36; p. 96, line 9; p. 104, line 14); that the assets of the company have been pledged to secure a \$3,000,000 bond issue under which bonds to the amount of \$2,250,000 are still outstanding; that on account of restrictions in the above mentioned mortgage it is impossible for the company to borrow the additional sums which are required without placing itself in default under said mortgage (Case, p. 84, line 33; 96, line 20; 104, line 13 *et seq.*), and that it cannot secure such sums by the sale of its present authorized but unissued capital stock because its stock is at present selling on the New York Stock Exchange at much less than par and in fact has not sold at a price equal to par for several years (Case, p. 96, line 15; p. 105, lines 10-20).

The principal question presented by the appeal is whether a corporation organized under our general corporation Act prior to the enactment of the law permitting the issue of stock without par value may amend its certificate of incorporation so as to authorize the issuance of such stock in order to secure capital which it imperatively needs and which it can secure in no other way, provided such new stock shall be offered to the existing stockholders *pro rata*.

ARGUMENT.

I.

The resolution was adopted by the Board of Directors in good faith for a legitimate corporate purpose.

In view of the proofs contained in the respondent's affidavits it seems unnecessary to consider this point at any length. While the appellants have made extravagant charges of fraud and bad faith, they submit not a word of proof to sustain them.

The answering affidavits not only emphatically deny the unsupported charges of bad faith and fraud but allege facts and circumstances which show that the sole purpose of the proposed amendment is to provide additional capital for the company without which its business cannot be successfully transacted. If, therefore, the corporation has power to issue non-par stock, the question as to the propriety of such issue is one which has been committed by the statute to the directors and the statutory majority of the stockholders, with the exercise of whose judgment this court will not interfere.

As was said by Justice Van Syckel, speaking for the Court of Errors and Appeals in *Berger v. U. S. Steel Corporation*, 63 N. J. E. 809, 829:

"Individual stockholders cannot question, in judicial proceedings, corporate acts of directors if the same are within the powers of the corporation and in furtherance of its purposes, are not unlawful or against good morals and are done in good faith and in the exercise of an honest judgment."

To the same effect see:

Farmers Loan & Trust Co. v. Hewitt
(N. J. Chan., 1922), 118 Atl. 267, 269;
affirmed on opinion below, 118 Atl. 926.
(Not yet officially reported);

Ellerman v. Chicago Junction Railways Co., 49 N. J. E. 217;
Edison v. Edison United Phonograph Co.,
 52 N. J. E. 620, 627;
Benedict v. Columbus Construction Co.,
 49 N. J. E. 23, 36;
Park v. Grant Locomotive Works, 40
 N. J. E. 114 (affirmed on opinion below
 45 N. J. E. 244).

II.

The Court of Chancery properly determined that the issue of non-par stock by the respondent violates no vested rights of appellants.

The right to issue non-par stock is derived from the supplement to the corporation act passed in 1920, P. L. 336, as amended by Chapter 284 of the Session Laws of 1921, P. L. 833.

This act applies by its terms to "*every corporation organized or hereafter to be organized*" under the General Corporation Act and permits the issuance of such stock "with such designations, preferences if any, and voting powers or restrictions or qualifications thereof as shall be stated and expressed in the certificate of incorporation or in any certificate of amendment thereof." There can be no question but that the legislature by these acts intended to confer upon corporations previously organized the power to issue non-par stock.

The appellants claim that the acts as applied to the respondent are invalid because they impair their vested rights as stockholders. The question presented is, therefore, whether the acts of 1920 and 1921 are valid legislation. If the legislation is valid

the respondent has the right to issue non-par stock. We contend, as the Court of Chancery determined, that the non-par-stock acts do not impair any vested rights of the stockholders of pre-existing corporations because they make no substantial change in such rights but merely provide a new method for securing substantially the same result as could have been secured under legislation existing at the time the respondent corporation was formed.

As above stated the respondent was incorporated in 1899 under the General Corporation Act of 1896. Section 27 of said act as it read in 1899 provided as follows (P. L. 1896, p. 285) :

“Every corporation organized under this act may change the nature of its business, change its name, *increase its capital stock*, decrease its capital stock, *change the par value of the shares of its capital stock*, change the location of its principal office in this state, extend its corporate existence, *create one or more classes of preferred stock*, and make such other amendment, change or alteration as may be desired.”

Under this section the corporation had undoubted power (1) to increase its capital stock, (2) to decrease its capital stock and (3) to change the par value of its shares of capital stock as well as (4) to create one or more classes of preferred stock.

1. *The power to increase its capital stock is unlimited.*

In the course of the exercise of this power a stockholder who is unable or unwilling to take his proportionate share of the increased stock may be deprived thereby of his proportionate control over the corporation and his *pro rata* interest in the assets thereof. This power may be exercised regardless of the relation which the actual value of the shares may bear to their par value.

In *Farmers Loan & Trust Co. v. Hewitt*, 118 Atl. 267; affirmed on opinion below, *Ibid.*, page 926 (not yet officially reported), a corporation having an authorized capital stock of 600 shares of the par value of \$10 per share, all of which were issued and outstanding, and having assets of the estimated value of \$9,000,000 proposed to issue bonds in the amount of \$594,000 convertible into common stock at par and proposed to offer these bonds *pro rata* to its existing stockholders. The same resolution provided for the increase of the capital stock from \$6,000 divided, as above stated, to \$600,000 divided into 60,000 shares of the par value of \$10 each. Stockholders owning one-third of the outstanding stock objected to the proposed increase and sought to enjoin it on the ground that they were unable to take their proportionate share of the bonds and thus could not secure their respective shares of the increased capital stock. They contended that under the circumstances their rights would be infringed (first) because the increase of stock would depreciate the value of their shares from \$15,000 to \$150 per share, and (second) because the other stockholders or outside interests would acquire upon the payment of only \$10 per share stock worth \$150 per share. In denying the injunction, Vice Chancellor Backes said in part:

"Their next point is that the proposed bond issue means, practically, the confiscation of their stock. It does mean the pledging of their stock, and, in effect, compelling them to contribute their proportion of the proposed loan, but I am not in sympathy with their pessimistic frame of mind, and hopeless attitude, that there will be a depletion of their capital interest. All the stockholders are to be dealt with alike. There is to be an equal apportionment of the bonds. There is to be no inequality in the burden to be borne or advantages to be gained. It is true that if any of the stockholders fail to respond they will suffer tre-

mendous loss in depreciation of the value of their stock, but their loss will be of their own making (citing *Berger v. U. S. Steel Corporation*, 63 N. J. E. 809)."

2. *The power to decrease its capital stock.*

The extent to which this power may be exercised is illustrated by the case of *Berger v. U. S. Steel Corporation*, 63 N. J. E. 809, in which it was determined by the Court of Errors that in the exercise of this power a corporation might borrow money secured by its bonds for the purchase of preferred stock for retirement. On this point the court said in part:

"The twenty-seventh and twenty-ninth sections of the Corporation act of 1896 expressly provide for the retirement of both classes of stock.

"The fifth section of the act provides 'that this act *and all its amendments* shall be a part of the charter of every corporation heretofore or hereafter formed under it, except so far as the same are inapplicable and inappropriate to the objects of such corporation.'

"The complainant, therefore, has no vested right to retain her shares in opposition to any lawful method provided for retiring them. Nor, under the provisions of our Corporation act, can any just basis be found for the assertion that her vested rights as a stockholder are impaired by the purchase by the corporation of its own shares of stock."

3. *The power to change the par value of the shares of its capital stock.*

No limit is imposed by the act upon the power of a corporation to change the par value of its shares of capital stock provided such change be accomplished by amendment to its certificate in the manner outlined in the act. No stockholder has a vested right to compel his corporation to maintain

his shares at any particular par value. Under Section 27 of the act as it existed at the time the respondent was incorporated, its certificate was therefore subject to amendment reducing the par value of its shares and thus creating a surplus.

Since under legislation effective at the time respondent was organized both the amount and the par value of the present capital stock of respondent is subject to the control of its directors acting with the consent of two-thirds of its stockholders, we submit that an act which permits the conversion of par value stock into stock having no par value or the issuance of a new class of stock having no par value is not a fundamental change in the contract between the corporation and the stockholders and does not impair any vested rights. On this point the Vice Chancellor said:

"The change desired by the defendant does not seem to me of such a fundamental character as to make the Allen case applicable. At the time this company was organized, it will have been observed, it was within the power of the statutory majority to increase its capital stock. It was also, under the act, permissible to change the par value of the shares. In substance and effect, this is precisely what was contemplated at the time these bills were filed. It is to be borne in mind that, in the judgment of the directors and a vast majority of stockholders no practical method of meeting the emergency with which they were faced was available except by an increase of its capital stock. Clearly, had it been desired the company could have reduced the value of its shares to the sum of \$25 each and thereupon have increased its common stock by the issue and sale of an additional 100,000 shares. In the scheme under consideration the same result is to be effected by increasing the capital stock, declaring no expressed value of the shares upon the certificates of stock, and selling the same for \$25 per share in the manner provided by law."

The power to provide for the issuance of stock without par value conferred by the acts of 1920 and 1921 is not therefore a fundamental change in the powers of the corporation but is merely a regulation with respect to the exercise of powers previously conferred. These acts point out a different method for accomplishing the same result which could have been accomplished under pre-existing legislation by a reduction in the par value of the existing stock and the issuance of additional stock of such reduced par value. In this respect the case at bar resembles *Berger vs. U. S. Steel Corporation, supra* (Court of Errors and Appeals), 63 N. J. E. 809.

In the case cited the U. S. Steel Corporation passed a resolution providing for the retirement of 2,000,000 shares of its outstanding preferred stock with bonds of the corporation to be issued for that purpose. The corporation was organized in 1901. On March 28, 1902, an act was passed which authorized such retirement.

It was contended that the proposed retirement of the preferred stock by the issuance of bonds was only authorized by the act above mentioned, and that since said act had been enacted subsequent to the incorporation of the company, the company could not take advantage of its provisions without the unanimous consent of its stockholders. The Court of Chancery adopted this view and issued its injunction restraining the corporation from retiring the stock in accordance with the proposed plan. This court, however, held that under the provisions of the Corporation act in force at the time the U. S. Steel Corporation was organized it had power to do substantially the same thing which was authorized by the act of 1902, and that the act of 1902 merely regulated the exercise of the pre-existing right. It therefore reversed the

decree of the Court of Chancery granting the injunction.

The appellants insist that their claim that the proposed amendment to the respondent's charter will impair their vested rights is supported by *Black v. Delaware & Raritan Canal Co.*, 24 N. J. E. 455; *Zabriskie v. Hackensack & New York R. R. Co.*, 18 N. J. E. 178.

Elkins v. Camden & Atlantic R. R. Co.,
36 N. J. E. 5.

Mills v. Central R. R. Co., 41 N. J. E. 1.

Allen v. Francisco Sugar Co., 92 N. J. E.
431.

The fact which distinguishes the cases cited from the case at bar is that in the cases cited the change proposed was a change in the whole purpose, object and character of the corporation, *e. g.*, the sale or lease of all its property for a long period of years or some other obviously fundamental change in the objects or business of the corporation. The vice chancellor in considering these cases said:

"It seems clear to me that the reasoning in the *Allen* case is not apposite to the determination of the question presented here. In all of the authorities relied upon in the case of *Allen v. Francisco Sugar Company (supra)*, both in this court and in the Court of Errors and Appeals, there was involved the question of the right of a corporation to dispose of practically all its property without legislative sanction against the objection of one or more of its shareholders. Of course, it is clear that this would work such a change in the original agreement of the stockholders as to disturb their vested rights and require unanimous consent of every individual concerned, no matter how small his holding might be (*Kean v. Johnson*, 9 N. J. Eq., 401; *Black v. Delaware & Raritan Canal Co.*, 24 N. J. Eq., 455; *Mills v. Central R. R. Co.*, 41 N. J. Eq., 1)."

The same decisions, with the exception of *Allen vs. Francisco Sugar Co.*, which was subsequently decided, were relied upon by the complainants in *Berger vs. U. S. Steel Corporation* but were regarded by this court as inapplicable to the facts of that case.

These cases do not determine that under the corporation act of 1896 no change of any kind or character can be lawfully made in the rights *inter sese* of stockholders of corporations organized thereunder.

In the opinion in the case last cited Justice Van Syckel referring to the provision of Section 5 of the Corporation act of 1896 (2 Comp. Stat., p. 1601), which provides that said act "*and all amendments thereof shall be a part of the charter of every corporation heretofore or hereafter formed hereunder except so far as the same are inapplicable and inappropriate to the objects of such corporation*" said:

"The language of the fifth section of the act of 1896 is very broad; 'This act and all amendments thereof shall be a part of the charter of every corporation heretofore or hereafter formed under it.'

"*It is difficult to perceive how any substantial force can be accorded to it, unless some amendment may be made which may affect the rights of stockholders inter sese to some extent.*

"In *Andrews v. Gas Meter Co.*, L. R.—1 Ch. 361 (1897), the defendant company was formed and registered as a limited company under the English Companies' act of 1856, but in October, 1862, it was registered under the Companies' act of 1862.

"On appeal the English court held that the case was to be determined by the act of 1862, and that a limited company, having no authority, under its memorandum or articles, to create any preference between different classes of shares, may, by special resolution passed under powers conferred by the Companies' act

of 1862, sections 50 and 51, alter its articles so as to authorize directors to issue preference shares by way of increase of capital.

"In *Allen v. Gold Reeve of West Africa (Limited)*, L. R.—1 Ch. 656 (1900), a limited company, by one of its articles, provided that it should have a lien for all debts and liabilities of any member of the company 'upon all shares (not being fully paid) held by such member.'

"The company, by way of purchase-money for the property acquired by it, allotted fully-paid shares to Z, a nominee of the vendor of the company; Z also applied for and had allotted to him shares not paid up. He was the only holder of fully-paid-up shares.

"At his death he was indebted to the company in arrears of calls on the unpaid shares, but his assets were insufficient to pay the arrears. Thereupon the company, by special resolution, under Section 50 of the Companies' act of 1862, altered the above article by omitting therefrom the words 'not being fully paid' thus creating a lien on Z's fully-paid shares.

"The English court of appeals, also, in this case ruled that the company had power to alter its articles by extending its lien to fully-paid shares, since he took them subject to the original articles, and the power of altering them given to the company by section 50.

"The judgment of the appellate court in these very recent cases was delivered after an exhaustive review of the previous decisions.

"While these cases are not controlling in this forum, they are instructive, as the declarations of very learned judges, exercising broad equity power, that the original articles of the company do not constitute such a fast-bound contract, between the shareholders *inter sese*, as to create vested rights which could not be unfavorably affected by an alteration of the articles in pursuance of the power given by section 50 of the Companies' act of 1862."

The learned Justice pointed out that the provisions of the 5th section of the act of 1896 were no part of the corporation law of this state at the time

of the formation of the corporations whose rights were involved in *Kean v. Johnson*, 1 Stock. 401; *Zabriskie v. Hackensack and New York R. R. Co.*, 3 C. E. Gr. 178; *Mills v. Central Railroad Co.*, 14 Stew. Eq. 1, and *Newark Library Association Case*, 35 Vr. 217. He states that these cases all dealt with the power of amendment and repeal under the act of 1846 which did not contain the provisions now contained in section 5 to which reference has above been made. While it is true that in the *Berger* case the case of *Kean v. Johnson* was accepted as a proper exposition of the law it is also true that this court expressed the view that if section 5 of the corporation act is to be interpreted as meaning what it clearly says, the legislature reserved thereby some power to affect the rights of stockholders *inter sese* by a subsequent amendment. Speaking further on this matter Justice Van Syckel at page 827, said:

"The law upon this subject which is of great moment is as yet in a formative state; a general rule upon a subject of so wide a range can be implanted in our jurisprudence only by gradual development, as questions arise for adjudication."

We respectfully submit therefore that the non par stock acts of 1920 and 1921 are applicable to respondent corporation and that action thereunder by respondent impairs no vested right of its stockholders.

If in fact it may be said that the rights of respondent's stockholders are at all affected, it is only to the extent permitted by the reservations contained in section 5 of the Corporation act.

III.

The resolution of May 3, 1923, does not illegally empower the directors to dispose of the non-par stock on such terms and under such conditions as they deem proper.

Appellants' counsel under Point V of their brief assume that the proposed amendment authorizes the Board of Directors to fix from time to time the price at which Class B stock may be sold, and argue, first, that under the Non-Par Stock act of 1921 such power cannot be conferred upon the directors by an amendment to a certificate of incorporation, and second, that the lodging of this power in the directors works a fundamental change in the rights of the old stockholders.

Assuming for the purpose of argument that the construction placed upon the Non-Par Stock act of 1921 by appellants' counsel is sound and that such act does not authorize an amendment to a certificate of incorporation conferring power upon the directors to fix the price from time to time at which non-par stock shall be sold, we submit that under the proposed amendment to respondent's charter the directors will not have power to fix such price except with the consent of two-thirds of the stockholders of each class having voting power. The language of the proposed amendment upon which counsel's argument is based is as follows:

"The Board of Directors may issue any authorized and unissued *Class A* common stock and *Class B* common stock, or either, at such times, respectively, and on such terms as in its discretion may seem best *and in accordance with law*" (Case, p. 163, line 21 *et seq.*).

The power to fix the terms of sale of the unissued Class A stock is of course limited by the statutory

requirement that such price must not be less than par. If counsel's construction of Section 121 of the Non-Par Stock act of 1921 (P. L., p. 834) is sound, then the power to fix the terms of sale of Class B stock confers no power upon the directors to fix the *price* of such stock except in accordance with law, *i. e.*, with the consent of two-thirds of the stockholders of each class having voting powers given at a meeting called for that purpose.

This is, in fact, the practical construction placed upon the proposed amendment by the directors themselves, for it appears from the resolution adopted by them that they intended to submit to the stockholders at the same time that the proposed amendment should be submitted the question of the price at which the stock should be offered *pro rata* to such stockholders. If the directors took the view urged by appellants' counsel that under this amendment they had power to fix the price at which the stock should be sold there would be no purpose in seeking authority from the stockholders for the offer to them of the stock at \$25 per share.

This construction of the Non-Par Stock act and of the proposed amendment to respondent's certificate of incorporation supports respondent's argument under Point II of this brief, for under it the price at which the non-par stock may be sold may only be fixed by two-thirds of the stockholders having voting powers; that is, by the same statutory majority of stockholders which under the law in effect at the time respondent was organized had power to change the par value of its capital stock.

The attention of the court is called to the fact that no plan has as yet been made for the sale of the stock in any manner except *pro rata* to the respondent's present stockholders at \$25 per share. There is nothing in the record to indicate that in the event that it shall become necessary to offer the stock to the public it will be offered at that price.

If and when the new stock shall be offered to outsiders it will be the duty of the directors and two-thirds of the stockholders to fix the best price obtainable for the stock, which of course cannot be less than the price at which it shall have been previously offered to the stockholders.

IV.

The proposed amendment will not injure the appellants because the stock is to be offered *pro rata* to all existing stockholders.

It is apparent that if each of the existing stockholders is allotted shares of Class B common stock his proportionate interest in the profits and assets of the corporation will not be affected by the amendment. As will be argued under Point V, the differences between the new stock and the old stock all operate in favor of the old, and the new stock is not given any preference as to share of profits over the old. If, however, in view of the dividend provisions applicable to the new stock the stock is worth more than \$25 per share, the rights of the stockholders are not affected by the offer to them at that price.

In *Farmers Loan & Trust Co. v. Hewitt*, 118 Atl. 267, to which reference has above been made, new stock worth \$150 a share was offered to the existing stockholders at \$10 per share, and it was held here, as in the Court of Chancery, that the rights of dissenting stockholders were not prejudiced thereby, because all had an equal right to participate in the new stock. Furthermore, if the Class B stock because of the provisions made for dividends thereon is worth more than \$25 per share,

the stockholders' right to subscribe for it at that price is a valuable right which can be sold by stockholders who do not desire to take their allotted shares.

Counsel for appellants argue under Point IV of their brief that under the proposed amendment the directors may dispose of the stock without offering it *pro rata* to the existing stockholders. This argument, we submit, is based on a palpable misunderstanding of the resolution of May 3, 1923 (Case, p. 162).

Paragraph 1 of such resolution authorizes the directors (1) to issue the new stock to the holders of the existing stock as a stock dividend; (2) to offer to the holders of the existing stock the right to subscribe for the same; or (3) otherwise dispose of the new stock *in accordance with law*, while the last part of the resolution authorizes the directors to offer the new stock to the holders of the existing stock *pro rata* at \$25 per share.

Referring to the above mentioned claim of the appellants, the Vice-Chancellor said:

"The resolution distinctly says that it (the new stock) must be disposed of in accordance with law, and not only is there nothing in the proofs to indicate that it will not be so disposed of, but, in addition thereto, any such attempt can be promptly and efficiently controlled. * * * But be that as it may, there is nothing to warrant the belief that the directors will deliberately fly in the face of the law, and if they do, there will then be a sufficient remedy."

It seems to us manifest that under the resolution above referred to, the directors cannot dispose of the stock without first offering it to the existing stockholders, for such a disposition would not come within the authority conferred by the resolution.

The letter of President Toro to the stockholders

of the respondent company which accompanied the formal notice of the stockholders' meeting states that the present plan was adopted out of deference to the wishes of some of the stockholders who desired the right to take their *pro rata* shares of the new non-par common stock (Case, p. 165, line 24 *et seq.*). This same letter states that there will be offered to the present stockholders one share of Class B common stock at \$25 per share for each share of the present stock held by them, respectively (Case, p. 166, line 2).

Notwithstanding the language of the resolution and the above recited promise contained in the letter of President Toro, appellants express the fear that it may be the purpose of the respondent to sell the stock to the Tobacco Products Corporation without first offering it to the existing stockholders. The affidavits submitted on behalf of respondent are very clear on this point. President Toro in his affidavit states:

"As above stated, the plan proposed in the resolution of March 13, 1923, has been finally and definitely abandoned, and the sole purpose of the present plan is to provide the necessary additional capital for the defendant in a manner which will afford to each stockholder an opportunity to secure his proportion of the new stock. It is the hope and desire of the Board that all of the stockholders will subscribe for and take the stock to be allotted to them under said plan. No arrangements of any kind or character have been made by said Board for the sale of said stock in any manner or to any person or corporation except by offering the same *pro rata* to the stockholders as outlined in said resolution" (Case, p. 89, line 38; p. 90, lines 1-15).

The affidavit of Harry Catlin, Secretary and Assistant Treasurer of the Company, states:

"The defendant has made no arrangement or agreement of any kind or character for the

sale of any of its capital stock proposed to be issued under the resolutions of May 3rd, 1923, to the Tobacco Products Corporation, or any of its affiliated companies, or to any person or corporation, or in any manner, except *pro rata* to its stockholders as set forth in said resolutions" (Case, p. 98, line 21 *et seq.*).

See also affidavits of Ambrose H. Burroughs (Case, p. 107, line 28 *et seq.*) and of Frederick L. Kenney (Case, p. 109, line 25 *et seq.*).

We do not claim that an unauthorized increase of stock becomes lawful merely by reason of the fact that the existing stockholders may subscribe for and secure their respective *pro rata* shares of the new stock. Our claim is simply that the proposed amendment is within the power of the corporation because it impairs no vested right of any stockholder, and that the rights of the existing stockholders to secure their respective *pro rata* shares of the new stock are amply safeguarded thereby.

V.

The restrictions imposed on the rights of the non-par stock are not *ultra vires* and violate no vested right of the appellants.

The resolution provides that the existing common stock shall be designated as Class A common stock and the proposed non-par stock shall be designated as Class B common stock (Case, p. 49, line 35 *et seq.*). It further provides:

"(a) that when and not until cumulative dividends of 7% shall have been paid on Class A common stock there may be paid dividends in the aggregate equal to \$7 per share on

Class B common stock for the fiscal year. As to all further dividends that may be declared for the fiscal year Class A common stock and Class B common stock shall share equally share and share alike.

“(b) Upon dissolution of the corporation or upon final distribution of its assets and after the payment of its debts Class A common stock shall be redeemed at par with accumulated dividends, if any, if the assets of the corporation including surplus and accumulated profits are sufficient; if the assets are not sufficient, then all said assets or their proceeds shall be distributed ratably among the holders of Class A common stock. If the assets are more than sufficient for such redemption all that remain thereafter shall be distributed ratably among the holders of said two classes of common stock” (Case, p. 162, line 27).

The appellants contend that by virtue of the provisions of the resolution above recited the existing common stock is converted into preferred stock; that this is in violation of their rights, citing *Einstein v. Raritan Woolen Mills*, 74 N. J. E. 624. They also contend that if the amendment shall become effective it will violate section 18 of the Corporation act of 1896 because the total amount of preferred stock issued and outstanding will exceed two-thirds of the capital stock paid for in cash or property.

We submit that the resolution in question does not convert the existing common stock into preferred stock and that it in no respect violates any vested right of the appellants. No question can be raised but that it was the purpose of the Non-Par Stock act as amended in 1921 (P. L. 1921, p. 833), to permit the issuance of non-par stock subject to the restrictions as to dividends and assets of the character above recited. The language of the statute is that such stock may be issued “with such designations, preferences, if any, and voting powers

or restrictions or qualifications thereof as shall be stated and expressed in the certificate of incorporation or in any certificate of amendment thereof."

The second paragraph of section 120 of the act as originally enacted provided as follows:

"The power to increase or decrease the stock as in the act to which this is a supplement is provided shall apply to all or any of the classes of stock, *but at no time shall the total number of the preferred shares with and without par value issued and outstanding exceed two-thirds of the entire number of shares of capital stock of all classes issued and outstanding.* Any preferred stock without any nominal or par value may, if desired, be made subject to redemption at any time after three years from the issue thereof at a price not less than the sum such corporation shall receive for said stock upon the issuance thereof, and the corporation shall be bound to pay thereon dividends at such rates and on such conditions as shall be stated in the original or amended certificate of incorporation not exceeding eight per centum per annum on the amount such corporation shall receive for said stock upon the issuance thereof, payable quarterly, half-yearly or yearly, and such dividends may be made payable before any dividend shall be set apart or paid on the common stock or stocks, and such dividends may be made cumulative; *provided*, the corporation shall set apart or pay the said dividends to the holders of non-cumulative preferred stock or stocks before any dividend shall be paid on the common stock or stocks."

The amendment of 1921 (P. L. 1921, p. 833), changes the second paragraph of section 120 of the act so that it now reads as follows:

"The power to increase or decrease the stock as in the act to which this is a supplement is provided shall apply to all or any of the classes of stock and any and all classes of stock without nominal or par value may be issued with-

out regard to the amount outstanding of any other class of stock. Any preferred stock without any nominal or par value may, if desired, be made subject to redemption at any time after three years from the issue thereof at a price not less than the sum such corporation shall receive for said stock upon the issuance thereof, and the corporation shall be bound to pay thereon dividends at such rates and on such conditions as shall be stated in the original or amended certificate of incorporation, payable quarterly, half-yearly or yearly, and such dividends may be made payable before any dividend shall be set apart or paid on the common stock or stocks, and such dividends may be made cumulative; *provided*, the corporation shall set apart or pay the said dividends to the holders of non-cumulative preferred stock or stocks before any dividend shall be paid on the common stock or stocks."

It was clearly the intent therefore of the legislature to authorize the issuance of non-par stock without regard to the amount of any other class of stock outstanding. The legislature undoubtedly recognized the fact that corporations having common stock with a par value would, on providing for the issue of non-par common stock, find it convenient to restrict the payment of dividends and distribution of assets on the non-par stock in favor of the common par stock. The act of 1921 was accordingly amended so as to settle beyond any question that the provision contained in section 18 of the act of 1896 limiting the proportionate amount of preferred stock that may be issued should have no application to the issuance of non-par stock subject to the restrictions of the kind above mentioned.

The imposition of these restrictions on the new non-par stock does not give to the old common par stock the characteristics of preferred stock, but, if it did, no vested right of the appellants would be thereby impaired.

The so-called preference to which the existing stock will become entitled under the resolutions all operate in favor of the existing stockholders and are benefits conferred rather than burdens imposed.

The case at bar is readily distinguishable from *Einstein v. Raritan Woolen Mills*, 74 N. J. E. 624, cited and relied upon by appellants. In that case the Raritan Woolen Mills was incorporated by a special act of the legislature which provided that its capital stock should be \$100,000 with the privilege of increasing the same from time to time to any sum *not exceeding* \$250,000. All of this stock was to be of one class, no provision being made for the issuance of preferred stock or of more than one class of common stock. The directors passed a resolution providing for the amendment of the company's charter by increasing the total capital stock of the company to \$525,000, \$150,000 of which should be 7% cumulative preferred stock and the remainder common stock. The resolution further provided that the then outstanding common stock amounting to \$150,000 should be converted into first cumulative preferred stock for which provision was made by the resolution.

It will be observed that this resolution made three important changes in the stock of the corporation none of which was authorized by any legislation existing at the time the company was formed. First, it authorized an increase of stock in excess of \$250,000, the limit fixed by the special act under which it was incorporated. Second, it created preferred stock which it had no power to do; and, third, it proposed to limit the right of the existing stockholders to participate in the profits of the company to cumulative dividends of 7% per annum whereas under the charter such stockholders were entitled to share *pro rata* in all profits which might be earned.

No more fundamental change in the relation of

stockholders to a corporation can be conceived. The case differs widely from the case at bar both in the power of amendment conferred upon the corporation at its organization and in the character of the amendment proposed.

The question whether the rights of the existing stockholders in the case at bar will be infringed by the proposed amendment is dependent upon the rights which they had as existing stockholders and the rights which they will have after the amendment becomes effective.

In the *Einstein* case the right of the stockholders, prior to the amendment, was to share *pro rata* in all of the profits of the corporation and in its assets upon dissolution. Under the amendment proposed in that case the only share in the profits which they would receive would be \$7 per share per annum and presumably the part of their stock upon dissolution. The existing stockholders of the respondent corporation are likewise entitled to all of the profits of the corporation and to their *pro rata* share of its assets upon dissolution but this right is qualified by the unlimited right of the respondent to provide for an increase of stock by amendment of its charter.

Under the respondent's proposed plan its existing stockholders are not only entitled to share in the profits of the company equally with the new stock but are given a precedence over the new stock as to a part of such profits. In other words under the proposed plan a share of the old stock will always receive dividends which will at least equal and may exceed the dividends paid on the new stock and on dissolution the old stock will under all circumstances receive \$100 more per share than the new stock.

Assuming that the respondent corporation has the right to issue non-par stock which would share *pro rata* share for share as to dividends and upon dissolution with the existing stock, it cannot be

doubted that it also has the right to provide for a preferential payment of dividends to the old stock so long as under no circumstances may a share of the new stock receive a larger dividend than that paid on a share of the old.

The preference given to the old stock in the *Einstein* case was a preference which carried with it a limitation which deprived the stockholders of their right to share in all profits in excess of cumulative dividends of \$7 per share and therefore the old stockholders were deprived of a substantial right. The preference given by the plan in the case at bar is a preference which carries with it no such limitation but which under all circumstances operates in favor of the old stock. For example, had the Raritan Woolen Mills earned in any year profits of 50% the old stock would have received but 7% on its par while the balance would have been distributed among the new common stock. On the other hand, if after the proposed amendment becomes effective the defendant should realize profits of 50% in one year such profits would be distributed share for share among the new and the old stockholders.

The provisions governing the distribution of profits on the two classes of stock insure an equal distribution share and share alike if the company shall pay dividends equal to or in excess of \$7 a share on both classes of stock. In the event that the dividends declared shall be less than this amount the old stock will receive at least \$7 per share while the new stock will receive the difference between this amount and the dividends distributed. It will be seen therefore that the preference always operates in favor of the old stock.

We submit therefore that the issuance of stock subject to these restrictions is not only specifically permitted by the Non-Par Stock act of 1921, but that under no circumstances can any right of the appellants be injured or impaired by reason of these

restrictions. Under these circumstances the appellants have no equitable right to restrain the proposed increase because of the restrictions imposed on the new stock for their benefit.

In *Willcox v. Trenton Potteries Co.*, 64 N. J. E. 173, the common stockholders of the Trenton Potteries Co. sought to enjoin the performance of an agreement between the company and its preferred stockholders under which the company agreed to issue to each assenting preferred stockholder a funding certificate for the arrears of dividends on his stock which should carry interest at 4% per annum and be payable exclusively out of the net profits of the corporation for the year and in priority to any dividends on the capital stock for such year. While the court held that such funding certificate could not be paid out of the profits to the exclusion of the non-assenting preferred stockholders from their proportionate share of such profits it said that the common stockholders had no standing in a court of equity to object to the scheme. Speaking on this point Vice Chancellor Stevens said in part:

"As to the objection taken to the scheme by the common stockholders, it seems to be quite untenable. It is manifestly for their benefit that the preferred stockholders should waive their right to the immediate payment of the dividends that have accumulated in the past and their right to all cumulative dividends in the future in consideration of a small reservation out of the earnings for a redemption fund and of a small payment thereof of interest, so called, both reservation and interest being non-cumulative, and being given in lieu of the company's obligation immediately to pay, out of all surplus earnings, all past dividends.

"This works to the benefit of the common stockholders, in that it greatly accelerates their chances of participation in dividends, by postponing the payment of the considerable sum of \$550,000, which is no longer an immediate

and prior charge upon all surplus earnings. If the earnings in any one year exceed the eight per cent. dividend due the preferred stockholders for that year and the two above-mentioned items, amounting together to less than \$50,000 per annum, the directors will be able to devote the excess to the payment of a dividend to the common stockholders, discharged of their obligation to make up dividends in arrears. *It is hard to understand how such an arrangement can be an irreparable injury to common stockholders—an injury which calls for the immediate interposition of this court by preliminary injunction.* If illegal, its illegality is not apparent. The case, on this branch of it, comes within the familiar rule of the *Citizens Coach Co. v. Camden Horse Railroad Co.*, 2 Stew. Eq. 299."

We submit therefore that the appellants' rights are in no way infringed by reason of these restrictions.

Appellants further contend that the resolution converts the existing stock into preferred stock and provides for dividends which may exceed 8 per centum per annum on such stock and claim that such provision violates section 18 of the Corporation act. If this were true we fail to see how appellants' rights would be infringed thereby.

We submit, however, that this contention is without force, first, as has above been argued, the stock is not preferred stock but is merely a class of common stock. Second, it is apparent from a reading of the provisions of section 18 that the limitation to 8% therein contained simply limits the *preference* which may be given to preferred stock and has no application to the right of such stock to share *pro rata* with other stock in any surplus distribution either by way of dividends or on distribution as may be provided in the charter or any amendment thereof. So far as we know

this point has never been passed upon by any court and it has never been suggested in this state that the statute should be construed as appellants' counsel contend.

Appellants' counsel argue, however, that under the proposed amendment Class B stock will also be preferred stock. They base this argument upon the provision which entitles such stock to a dividend of \$7 per share after cumulative dividends of that amount shall have been paid on the Class A common. Appellants at the same time insist that the Class A stock is preferred over Class B. If, then, Class B is also preferred, over what stock does it have a preference?

VI.

The provision contained in the proposed amendment, requiring the consent of the holders of two-thirds of class "B" common stock in addition to the consent of the holders of two-thirds of Class "A" common stock in order to authorize the issue of any other class of stock by the corporation, is valid.

Appellants claim that the provision contained in the resolution which provides that in order that any other class of stock may be authorized, not only the consent of those holding two-thirds of the issued and outstanding shares of Class "A" common stock shall be given, but as well the consent of those holding two-thirds of the issued and outstanding class "B" common stock, is unlawful (Case, p. 163, line 29 *et seq.*). They refer to section 27 of the Corporation Act which requires, as

a prerequisite for the creation of a new class of stock, the consent of two-thirds in interest of each class of the stockholders having voting powers, and argue that this means necessarily two-thirds in interest of each class of the stockholders having general voting powers.

Section 18 of the Corporation act of 1896 provides as follows:

“Every corporation shall have power to create two or more kinds of stock of such classes, with such designations, preferences and voting powers or restriction or qualification thereof as shall be stated and expressed in the certificate of incorporation; and the power to increase or decrease the stock as in this act elsewhere provided shall apply to all or any of the classes of stock.”

It seems to us clear that under the Corporation act, as it existed at the time the respondent was organized, it had power to create a class of stock which would have no voting power except on the question of the creation of a new class of stock by amendment to the certificate of incorporation and which would have a vote on this question. This we believe to be in accordance with the general practice and to be fully sustained by the provisions of the Corporation act. The class “B” common stock in the case at bar has a restricted voting power which gives it a right to pass upon any amendment to the certificate of incorporation creating a new class of stock, but which does not permit it to vote upon any other question.

At the argument in the Court of Chancery, counsel cited an unreported opinion of Vice Chancellor Griffin in the case of *Costello v. Cusack Co.* As we understand this opinion, the learned Vice Chancellor held that a proposed amendment to the charter of the Cusack Company was invalid because it took from the directors, as well as from

the stockholders, the power to effect a voluntary dissolution of the company in the manner provided by section 31 of the Corporation act. The amendment in question required the consent of the holders of record of *two-thirds in interest of the outstanding class "A" stock* as a prerequisite to the right of the corporation to voluntarily dissolve.

Section 31 requires that the resolution of the directors providing for the voluntary dissolution of a corporation shall become effective if approved by two-thirds in interest of *all* of the stockholders. It will be seen that under the proposed amendment in the *Cusack* Case more than two-thirds of all the stockholders might approve the resolution to dissolve, but if more than one-third of the class "A" stockholders failed to approve, the company could not under its amended charter dissolve. This is contrary to the provisions of section 31. There is, however, no analogy between the facts in the *Cusack* Case and the facts of the case at bar.

In *General Investment Co. v. Bethlehem Steel Corp.*, 87 N. J. Eq., 234, 240, Vice Chancellor Lane, speaking of the contention made in that case that a class of common stock without voting power could not be created, and, referring to section 18 of the corporation act, said:

"No broader language could have been used, and unless the usual meaning of these words is to be restricted by reason of the existence of some public policy, it is inconceivable to me that a corporation may not issue this class of common stock, or call it what you will. I have failed to find the existence of any such public policy. The matter is one for the stockholders to determine by their contract."

We submit that the qualified voting power given to the class "B" common stock contravenes no provision of the Corporation Act and does not impair any right of the appellants.

VII.

A preliminary injunction will result in irreparable injury to the respondents and should not issue in view of the unsubstantial character of appellants' objections and their insignificant stock holdings.

The proof submitted in behalf of respondents clearly shows that irreparable injury will result to the corporation and its stockholders if a preliminary injunction were issued.

Although the business of respondent was successfully conducted from the time of its organization until the beginning of the year 1921, it has not been in a condition to pay cash dividends since June, 1917, the scrip dividends paid since that time having been redeemed by the issuance of stock and not by the payment of cash (Case, p. 80, line 10 *et seq.*). During the year 1921 the respondent was obliged to close its factories for eight months because of labor troubles which resulted in a loss to the company during that year of \$2,704,394.92 (Case, p. 81, line 16 *et seq.*). During this time respondent's brands of cigars were practically withdrawn from the market and suffered a marked loss of prestige which has not yet been regained (Case, p. 80, line 38; p. 81, line 26).

Although, as stated in the statement of facts in appellant's brief, respondent made a profit of approximately \$150,000 (before depreciation) during the last quarter of 1922, the net loss for that year, notwithstanding the profit arising from the business conducted during the last quarter was \$390,238.41. During the first three months of the current year the business of the company was conducted at a profit of only \$3,205.27 (Case, p. 82, line 11 *et seq.*).

Appellants' counsel in their statement of fact suggest that respondent in its affidavits should have shown the results of its business transacted since March 31st, 1923. Attention is called to the fact, however, that the second quarter of the year did not end until June 30th, which was eleven days after the affidavits in this cause were sworn to and nine days after the cases were argued before the Vice Chancellor. In the case of a business operation of the magnitude of that conducted by respondent it would be impossible to state with accuracy the result of its operations without closing and balancing its books at the end of a definite accounting period. There is nothing in the case from which it can be inferred that respondent's business has materially improved since the end of the first quarter, during which its profits were so insignificant as to be negligible. At all events the affidavits clearly show a most urgent *present* need for a large amount of additional capital.

On December 31, 1920, the respondent had a floating indebtedness of \$3,050,000 which it was obliged to fund by issuing its bonds in the amount of \$3,000,000 payable in ten years with interest at the rate of eight per centum per annum. This loan was not procured as alleged in appellant's statement of facts for the purpose of replacing the losses sustained during 1921, as those losses were not ascertained until eight or nine months later. The bonds above mentioned were secured by a trust agreement containing sinking fund provisions requiring the respondent to redeem a definite amount of bonds each year (see affidavit of Luis Toro, paragraph 11, Case, p. 81, line 27).

This trust agreement also contains a provision which requires the respondent to maintain at all times current assets at an aggregate amount equal to at least 175% of the aggregate amount of its liabilities (Case, p. 84, line 33 *et seq.*).

During the year 1922 respondent was unable,

because of lack of funds, to make its usual purchases of Porto Rican tobacco and at the present time its stock of tobacco does not exceed one-half of its normal requirements. The 1923 crop of such tobacco is now being marketed and the respondent is without funds to replenish its stock. It imperatively needs *at this time* at least \$1,000,000 additional capital for this purpose (Case, p. 83, lines 12-33).

The business of the company is wholly dependent upon the prestige of its brands of cigars which has been built up by it at a cost of millions of dollars during the last twenty years. The extent of the loss of prestige sustained by these brands, as a result of respondent's suspension of operations, is illustrated by the statement contained in paragraph 12 of the affidavit of Luis Toro, President of the company, showing that during the year 1922 the sales made by the company of its two leading brands equalled 55,000,000 cigars as compared with sales of the same brands in 1920 equalling 113,000,000, representing a loss of 51% (Case, p. 81, line 38; p. 82, line 10).

Last June the respondent commenced an extensive advertising campaign for the re-establishment of its brands. Its advertising contracts for June and July involved an expenditure of \$175,000. The continuance of this campaign during the current year is essential if the company is to regain its lost business. If this is to be done it must secure, without delay, \$500,000 additional capital for this purpose (Case, p. 84, line 22).

It will be seen, therefore, that the interest of the stockholders of the respondent will seriously suffer unless it shall be able to secure at least \$1,500,000 without delay.

It is unable to borrow a substantial part of the amount needed without violating the above men-

tioned provision of the trust agreement securing its outstanding eight per cent. sinking fund gold bonds which requires it to maintain current assets at all times of an aggregate amount equal to at least 175% of the aggregate amount of all its liabilities. On March 31, 1923, the ratio of its current assets to its liabilities was 1.85 to 1.00. An increase of liabilities of \$250,000 without an increase of assets would place the respondent in default under the above mentioned provision (Case, p. 104, lines 17-29).

It cannot secure such additional capital by a sale of any of the unissued shares of its present authorized capital stock because its outstanding stock is now selling and since November, 1920, has sold at much less than par (Case, p. 96, line 15 *et seq.*; p. 105, lines 10-20).

The urgent need of the company for this additional capital appears conclusively and in detail from the affidavits of Luis Toro, President of the company, Harry Catlin, its Assistant Treasurer, and Thomas C. Breen, its Auditor. Neither the financial condition of the company nor its urgent need of capital is in any way disputed by appellants.

It is of vital importance to the company that it immediately have the necessary capital which the proposed issue of stock will produce. The granting of a preliminary injunction, therefore, will work irreparable injury to the company and its stockholders.

The affidavits further show that at the time of the argument in the court below 275 stockholders owning in the aggregate substantially more than two-thirds of respondent's entire outstanding stock, had sent their proxies to the officers of the company to be voted in favor of the proposed plan (Case, p. 97, line 26). As against this, the stock holdings of the appellants are insignificant:

The language of Justice Van Syckel, speaking for this Court in *Berger v. U. S. Steel Corporation* (*supra*), 63 N. J. E. 809, is in point:

"In the presence of the fact that over ninety-nine per cent. of all the stockholders in attendance at the meeting, personally or by proxy, voted in favor of the resolution, it cannot reasonably be expected that the court is impressed with the belief that the complainant will suffer any substantial injury by the consummation of the scheme. Nevertheless, if it appears that the proposed action is without legal authority, the complainant cannot be denied the relief which she seeks, *but, in passing upon this controversy, the greatest care must be observed that this overwhelming majority of the stockholders are not deprived of their rights by the very few dissentients.*"

In the case of *General Investment Co. v. Bethlehem Steel Corp.*, 87 N. J. E. 234, Vice-Chancellor Lane said:

"5. In *Fielden v. Lancashire and Yorkshire Railway*, D. G. Sm. 535; 64 English Reprint 237, a case somewhat similar to this was brought to the attention of Vice Chancellor Sir Knight Bruce. It appeared that the corporation was about to issue something over one million pounds of preferred stock, and the act was alleged to be *ultra vires*; the bill was filed by a holder of something like fifty-four shares out of a total of one thousand to enjoin the issuance of the stock. None of the stock had been issued at the time of filing of the bill, but 770,000 pounds had been subscribed for and a payment of some ten per cent. made on account. In the present case, the stock has been subscribed for by the syndicate. There has been no payment made on account. *The report states that the court was of opinion that much more mischief was likely to be done by 'interfering now in a manner from which the court might afterwards see reason to depart, than by declining to interfere upon the present occasion, although it might ultimately appear that*

the plaintiff was entitled to the interposition of the court.' The court was therefore of opinion it ought not to grant the injunction; but it desired that it be understood as giving no opinion on the question of right.

"I should, therefore, be inclined, in this case, under the circumstances, even though it appeared to me that there might be some doubt as to whether this company had the power to issue this stock, to decline to interfere at this stage of the proceedings, and that upon the ground referred to in the above-cited case.

"The order to show cause will be discharged and the restraint vacated." (*Italics ours.*)

In the subsequent case of *General Inv. Co. v. Bethlehem Steel Corp.*, 88 N. J. E. 237, which was an application made to the Court of Chancery to enjoin an amendment to a certificate of incorporation providing for an increase of capital stock, Vice-Chancellor Lane said:

"Assuming that this plan is approved by practically unanimous consent, is the court obliged at the suit of this single stockholder to protect his strictly legal right, to act in such a manner as would cause great harm to every other interest in the concern, and perhaps the general public, merely because the questions presented by him may be arguable; to cause mischief which, if on final hearing it decides that it erred or if the court of errors and appeals finds it erred, it cannot undo?"

In the case last cited the application for preliminary injunction was denied by the Court of Chancery and application was made to this Court for a stay pending appeal, which was likewise denied.

At the utmost the proposed issue of stock will not infringe any substantial right of appellants. It cannot seriously be considered that they actually fear any real loss if the new stock shall be issued in accordance with the proposed plan, or that any such fear if it exists would be well grounded. Their

claims are merely technical rather than substantial. On the other hand it clearly appears that the respondent is in dire need of funds which it must have and which as a practical matter it can secure in no other way, at least not in any way as fair to its present stockholders as the proposed plan. If a preliminary injunction shall be issued at the suit of the holders of a relatively insignificant amount of stock the business of the respondent will be seriously impaired and the great body of its stockholders will suffer irreparable injury. If under these circumstances the proposed plan infringes any right of appellants (which we deny), they should be left to assert such right in a suit at law or to be compensated therefor by damages to be assessed by the Chancellor.

In *Beling v. American Tobacco Co.*, 72 N. J. E. 32, at page 44, Vice-Chancellor Pitney, in dismissing a bill filed by a stockholder who objected to a merger of his company with another corporation, said that in his judgment an action at law was ample to give to the complainant the full value of his stock at the time of the merger.

In *Brugler v. United Shoe Machinery Co.* (June Term, 1917, not reported), referred to by Vice-Chancellor Lane in his opinion in *General Inv. Co. v. Bethlehem Steel Corp.*, 88 N. J. E. 237, this Court, upon an application to stay a decree of the Court of Chancery discharging an order restraining the merger of two corporations, denied the stay upon condition that the defendant company give a bond conditioned to pay such damages to the complainant as might be assessed by the Chancellor. This was done in a merger case where it is fair to assume that the necessity of the company for immediate action was not as great as in the case at bar.

The appellants insist, however, that the two cases last above cited are distinguishable from the

case at bar on the ground that they are merger cases and not cases involving an increase of stock. We submit that this difference in facts affords no basis for distinguishing them on this point. The purpose of the bill of complaint in the *Brugler* case was to enjoin the merger of the complainant's company with another corporation on the ground that the merger agreement did not afford him an opportunity to participate in the new company on a fair basis. If this was true the corporations had no right to merge thereunder and condemn his stock.

The right to take his stock could only arise after he had had an opportunity to participate in the merged company under an agreement fair as to him. If the loss of this right could be compensated in damages, as this Court undoubtedly believed that it could, we fail to see why any damage occasioned appellants by the issue of the stock in question, if it violates any of their rights, cannot likewise be so compensated.

We respectfully submit that the decree of the Vice Chancellor denying a preliminary injunction should be affirmed.

Dated, October 3, 1923.

Respectfully submitted,

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