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STOCK, CORPORATE SHARES OF—CORPORATE EVIDENCES OF DEBT—CERTIFICATE OF INDEBTEDNESS—FEE—COMPUTATION—ARTICLES OF INCORPORATION—SECTION 176 G. C.

SYLLABUS:

Distinction between corporate shares of stock and corporate evidences of debt discussed.

Columbus, Ohio, July 27, 1948

Hon. Edward J. Hummel, Secretary of State
Columbus, Ohio

Dear Sir:

This will acknowledge receipt of your request for my opinion which reads as follows:

> "A certificate of Amendment to the Articles of Incorporation of G. H. Consumer Services, Inc., has been tendered to this office for filing.
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> "G. H. Consumer Services, Inc., was incorporated May 20, 1938, as a co-operative trade association under Sections 10185 and 10186 of the General Code of Ohio.
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> "The Certificate of Amendment among other things provides the total amount of money for which this corporation may issue evidence to certify to the fact that the treatments of indebtedness in the form of its co-operative Patronage Savings Certificates and co-operative Investment Certificates shall not exceed at any time a total of $250,000.00.
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> "The Amendment also provides that the holder of any of these certificates shall receive interest at the rate of not to exceed 5% per annum and shall be non-cumulative.
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> "A further provision provides the maximum number of units for which the corporation may have its co-operative Investment Certificates outstanding at any one time is one thousand issuable for $100 per unit payable only upon the dissolution of this corporation; and
>
> "The maximum number of units for which the corporation may have outstanding at any one time of its co-operative Patronage Savings Certificates is fifteen thousand issuable for $10 per unit, payable only upon the dissolution of this corporation.

"The certificate of amendment also contains provisions restricting the negotiability of both classes of the certificates. The corporation also reserves the right to redeem any of the above mentioned certificates at the issued price.

"It is apparent the corporation has devised this plan of raising its operating capital through the sale of these certificates which have many of the incidents of shares of stock.

"Your opinion is therefore requested regarding the proper manner of computing the fee for the filing of this certificate. Should each unit described therein be considered as equivalent to one share of stock and the fee then computed in accordance with the provisions of Section 176 of the General Code of Ohio?

"A photostatic copy of the proposed Certificate of Amendment is enclosed for your information.

"We also call your attention to a recent decision in the United States Supreme Court in the case of Kelley v. Commissions, in which it was held that debenture bonds were evidence of indebtedness and were not to be treated as shares of stock. Counsel for the corporation did not have the citation on this decision."

The G. H. Consumer Services, Inc., was incorporated in April, 1938, as a not for profit corporation under Sections 10185 and 10186, General Code, which sections provide as follows:

Section 10185, General Code.

"An association incorporated for the purpose of purchasing, in quantity, grain, goods, groceries, fruits, vegetables, provisions, or any other articles of merchandise, and distributing them to consumers at the actual cost and expense of purchasing, holding, and distribution, may employ its capital and means in the purchase of such articles of merchandise as it deems best for itself, and in the purchase or lease of such real and personal estate, subject always to the control of the stockholders, as are necessary or convenient for purposes connected with and pertaining to its business."

Section 10186, General Code.

"Such association may adopt such plan of distribution of its purchases among the stockholders and others as is most convenient, and best adapted to secure the ends proposed by the organization. Profits arising from the business may be divided among the stockholders from time to time, as it deems expedient, in proportion to the several amounts of their respective purchases."

In opinion No. 4143, Opinions of the Attorney General for 1935, it was held that such a corporation must be organized as a not for profit corporation and such corporations have been recognized by the legislature of Ohio as not for profit corporations. See Sections 5495 and 5495-2, General Code, as amended in 1947.

While under the General Corporation Act, Section 8623-102, General Code, corporations not for profit may not issue stock, those special corporations incorporated not for profit under Sections 10185 and 10186, General Code, are permitted by the very wording of those statutes, to issue stock. However, it is to be noted that profits of such corporations are divided among the stockholders not according to stock holding, but in proportion to the amount of their respective purchases.

Section 176, General Code, provides for the payment of fees to the Secretary of State on authorized shares of stock and Section 10186-30, General Code, now provides in part as follows:

> "* * * Such association organized hereunder and under Sections 10185 and 10186 of the General Code shall pay the same fees as are required to be paid by corporations organized for profit with respect to the issuance of shares of stock as provided in Section 176 of the General Code."

The above, we think, demonstrates that such corporations, although corporations not for profit, may issue stock and if they do so, must pay the fees as provided for in Section 10186-30, General Code, computed as set forth in Section 176, General Code.

Let us determine whether such a corporation may borrow money and issue notes, debentures, etc., therefor. No such specific authorization appears in Section 10185 or Section 10186, General Code. It has been held that authority to borrow money and give evidence of indebtedness clearly is an implied power which corporations may exercise whenever necessary to carry out their purposes. See 10 O. Jur., Corporations, Section 695. While no such specific authorization appears in Sections 10185 and 10186, General Code, to borrow money and issue notes, as has heretofore been pointed out, such corporations must be organized as not for profit corporations and such corporations have such power as will now be shown.

Section 8623-132, General Code, provides in part as follows:

> "In cases where special provision is made in the General Code for the incorporation, organization, conduct or government of any class of corporations, such special provision shall govern to the exclusion of the provisions of this act on the same subject, unless it clearly appears that the special provision is cumulative, in which case the provisions of this act also shall apply. * * *"

It would seem that Sections 10185 and 10186, General Code, are cumulative. Therefore, a cooperative trade association has the power given to not for profit corporations not inconsistent with the above two mentioned statutes. Section 8623-99, General Code, gives not for profit corporations power "to borrow money and contract debts to accomplish its purposes." It would follow then, that they would also have the power to issue evidences of these debts.

The question remains to be determined whether the so-called certificates provided for in the proposed amendments are in fact shares of stock or evidences of debt.

The proposed amendments to the articles of incorporation of G. H. Consumer Services, Inc., provide, so far as pertinent to our question, as follows:

"ARTICLE IV

MEMBERSHIP AND FUNDS

* * *

B.1. The total amount of money for which this corporation may issue evidences to certify to the fact and terms of indebtedness in the form of its CO-OP PATRONAGE SAVINGS CERTIFICATES and CO-OP INVESTMENT CERTIFICATES, shall not exceed at any time a total of $250,000.

2. A holder of any such CERTIFICATES shall receive interest thereon at a rate not to exceed 5% per annum, non cumulative, of the total amount received by the corporation for such CERTIFICATES, provided that if the INTEREST FUND, hereinafter defined, is not sufficient to pay such 5% to all holders of such CERTIFICATES, each holder shall receive such proportionate share of the said INTEREST FUND as the total dollar amount of his holdings at the end of any calendar year bears to the total dollar amount of all such CERTIFICATES outstanding as of the

end of any such calendar year. The first interest payment on any CERTIFICATE, however, shall not exceed that proportion of the total amount of interest payable if the Corporation had the use of the money for 12 calendar months, which the total of full calendar months during which the Corporation actually had the use of the money bears to 12. All interest payments for any year shall be made only from the corporation's INTEREST FUND, which, for any year shall not exceed one-third of the Corporation's total net earnings for such year as conclusively determined by the Corporation's auditor for patronage savings and income tax purposes. Interest shall be payable within 60 days after such earnings are so determined.

3. The maximum number of units for which the Corporation may have its CO-OP INVESTMENT CERTIFICATES outstanding at any one time is 1,000, issuable for $100.00 per unit, payable only upon the dissolution of this Corporation after the payment in full of all its promissory notes and secured and general obligations.

4. The maximum number of units for which the Corporation may have outstanding at any one time, its CO-OP PATRONAGE SAVINGS CERTIFICATES is 15,000, issuable for $10.00 per unit, payable only upon dissolution of this Corporation after the payment in full of all its promissory notes, secured and general obligations and all its CO-OP INVESTMENT CERTIFICATES.

5. No holder of a membership certificate or CO-OP INVESTMENT CERTIFICATE, or CO-OP PATRONAGE SAVINGS CERTIFICATE, issued by this Corporation, shall sell, transfer, assign, or otherwise dispose of his interest in any such CERTIFICATE without having first offered the sale or other disposition of such CERTIFICATE to this Corporation by depositing it with this Corporation along with a written offer of sale or other disposition to this corporation at any price not in excess of the amount for which such CERTIFICATE was originally issued by this Corporation. If the board of trustees of this Corporation shall notify the holder making such offer within 90 days after the holder has deposited such CERTIFICATE with this Corporation that his offer is accepted, the Corporation shall, within six months after such deposit, cause the holder to be paid the offered price thereof. If the Corporation fails to accept such offer within the time provided herein, the holder may sell, transfer, or otherwise dispose of such CERTIFICATE so offered to any purchaser or transferee, provided that, in case of MEMBERSHIP CERTIFICATE, the new transferee shall comply with all the requirements then in force for membership

> in this Corporation except the payment of that part of the membership fee in force at the time of the issuance of such membership so offered for sale or other disposition. * * *"

Your letter has pointed out certain characteristics of these certificates which are commonly attributed to shares of stock and some of which may also belong to certificates of indebtedness. It is difficult to draw a sharp line between stocks and certificates of indebtedness in the so-called hybrid securities. See 13 N. Y. University Law Journal, 407, Hanson on Hybrid Securities; 23 Wash. University Law Journal, 102 Uhlman on Hybrid Securities.

The articles of incorporation and the amendments thereof under consideration do not contemplate having stockholders or issuing stock in the ordinary sense as a means of raising capital but that the capital is to be raised by selling the so-called certificates. These so-called certificates are non-maturing, that is, they are payable only on the dissolution of the company and then only after certain other obligations are paid. The articles provide for setting up of an interest fund not to exceed for any year one-third of the corporation's total net earnings, and the paying of interest of a stated amount on the certificates if the interest is sufficient to pay such an amount, and of a lesser proportionate amount in the event the interest fund is not sufficient to pay the full amount. This contemplates the paying of interest only in the event that the company has net earnings. Limitations are placed on the right to sell or transfer the above mentioned certificates and also members' certificates without first offering the same to the corporation at a pre-determined price and the power to exercise this preemptive right is given to the corporation. Membership is provided for in the articles upon compliance with the terms set out in the Code of Regulations, which Code is not before me, however, the control of the company seems to be vested in the members who alone are given the right to vote.

While the amended articles speak of membership certificates the certificates are not defined in the articles but apparently are provided for in the Code of Regulations and your inquiry does not appear to be directed toward the character of these membership certificates. It should be pointed out that the membership certificates also are restricted as to transfer and are redeemable by the corporation and that the corporation is given the power to repurchase them. It would seem also that upon final dissolution

of such a corporation the assets remaining after paying all other obligations would belong to and remain in the members.

In considering the problem created by the use of these types of certificates, tests of similarity and difference may be applied—in what respects does the certificate resemble a stock and in what ways does it fulfill the commonly accepted requirements for a bond; then, what provisions or omissions point toward a conclusion that the certificate can not be stock or bond as the case may be. The certificates in question are nonmaturing; there is no absolute promise to pay any sum of money either as principal or interest; interest being definitely contingent upon the setting aside of an interest fund from net earnings; principal being payable only upon dissolution and then only after certain other obligations have been paid. The general credit of the corporation is in no way placed in obligation for the payment of interest or the repayment of the certificates. This would seem to indicate that the certificates are not bonds but stock and the holders thereof owners in the business who have ventured their capital in a business enterprise.

There is one case of last resort in Ohio which lends support to the above distinction, namely, the case of Miller v. Ratterman, 47 O. S. 141, where the contention that certificates of indebtedness, rather than of preferred stock, had been issued was overruled, it was argued that evidence of debt was indicated by provisions denying the right to vote, guaranteeing the right to dividends, and providing for security by mortgage, together with a recital that no further mortgage should be given to the prejudice of the preferred stockholders, and a guaranty of dividends by a lessee which had executed a mortgage to secure their payment. In overruling that contention, after noting special statutory provisions, the court called attention to the absence of any provision for the payment of the principal sum advanced, said that the stipulation denying the right to vote indicated that the certificates represented stock, "for the inhibition against voting would be wholly useless had it been intended that the holders should become creditors," and stated that the stipulation guaranteeing to the holders of the preferred stock payment of dividends thereon did not negative the idea that they were stockholders, not being a stipulation to pay dividends in any event.

More directly in point is the case of Bd. of Trustees of Tift College v. Barrow County Cotton Mills, 39 Ga. App. 261, 146 S. E. 637, where

it was said that "where a certificate issued by a corporation and denominated 'preferred stock' in a certain amount provides for the payment of dividends out of the net profits of the corporation at the rate not exceeding a certain per cent when the corporation has earned this amount, and provides that the stock shall be redeemable at the option of the corporation, after a certain period of time, at its par value with accrued dividends, and where the resolution of the corporation under the authority of which the certificate was issued contains substantially the same provisions, the certificate is not an evidence of indebtedness from the corporation to the holder of the certificate, but is only a certificate of preferred stock."

See also Inscho v. Mid-Continent Development Co. (1915), 94 Kan. 370, 146 P. 1014, Ann. Cas. 1917B, 546; In re Culbertson (1932 C. C. A. 9th, 54 F. (2d) 753; and Young v. Lyons Mill. Co. (1927), 124 Kan. 83, 257 P. 717.

I am therefore of the opinion that the certificates provided for in the proposed amendments to the articles of incorporation of G. H. Consumer Services, Inc., are shares of stock and not certificates of indebtedness and as such each unit described therein is to be considered as a share of stock and is subject to the fee computed in accordance with the provisions of Section 176, General Code.

Respectfully,

HUGH S. JENKINS,
Attorney General.