

Suspension of Dividend Payments and COVID-19

Due to the COVID-19 pandemic and resulting economic uncertainties, some corporations are re-considering paying already-declared dividends. A corporation's board of directors should take into account certain factors when determining whether to make dividend payments.

Typically, when a board of directors declares a dividend, it also establishes the date for determining whether shareholders are entitled (by virtue of their ownership of shares) to receive the dividend (the "record date") and the date following the record date on which the dividend is to be paid (the "payment date"), which cannot be more than sixty days after the record date.¹ The record date is usually set as a date after the declaration date. However, if the corporation does not set a record date, the record date is the close of business on the day that the board of directors adopts the resolutions approving the dividends.² Under both the Delaware General Corporations Law ("DGCL") and New York Business Corporations Law ("NYBCL"), the declaration of dividends creates a debtor-creditor relationship between the corporation and its shareholders. If payment is not made on the payment date, shareholders have a possible cause of action against the corporation.³

However, while the declaration of a dividend creates an obligation to pay the dividend on the payment date, state law and a corporation's organizational documents could limit a corporation's obligation to pay. Both the DGCL and NYBCL require dividends to be paid out of a corporation's "surplus."⁴ If a corporation does not have sufficient surplus on the payment date, both the DGCL and NYBCL prohibit payment of the dividend, subject to certain exceptions.⁵ A corporation's organizational documents may further limit the obligation to make dividend

¹ See DEL. CODE ANN. tit. 8, §213 (West 2020) and N.Y. Bus. Corp. §604 (McKinney 2020) (setting out the requirements for fixing a record date).

² See Del. Code Ann. tit. 8, §213 and N.Y. Bus. Corp. §604.

³ See, e.g., *Selly v. Fleming Coal Co.*, 180 A. 326, 328 (Del Super. Ct. 1935) ("It seems to be true that upon the declaration of a lawful dividend by a Board of Directors that the relation of debtor and creditor is set up between the corporation and the stockholder. In most cases the right set up in the stockholder is an irrevocable right and the declaration of the lawful dividend creates an obligation of the corporation and there exists a right of action on the part of the stockholder to enforce its payment."); *Gordon v. Elliman*, 119 N.E.2d 331, 334 (N.Y. 1954) ("When a dividend has lawfully been declared, the relation of debtor and creditor is created between the corporation and each stockholder for his proportion of the dividend. If the corporation refuses to pay, each stockholder may recover it in his own right in an action against the corporation."); *Jacques v. White Knob Copper & Dev. Co.*, 23 N.Y.S.2d 326, 328 (N.Y. App. Div. 1940) ("The relationship between a corporation and a stockholder with respect to the latter's share of a dividend declared by the corporation is that of debtor and creditor. At any time after the date fixed for the payment of each dividend, a holder of stock may maintain an action at law to recover the sum due.").

⁴ DEL. CODE ANN. tit. 8, § 170; N.Y. Bus. Corp. LAW § 510. "Surplus" for this purpose is defined in the DGCL as "the excess, if any, at any given time, of the net assets of the corporation over the...capital...", as determined by the board of directors, see Del. Code Ann. tit. 8, § 154, and in the NYBCL as "the excess of net assets over stated capital," see N.Y. Bus. Corp. Law §102. "Net assets" in both the DGCL and NYBCL are defined as "the amount by which the total assets exceed the total liabilities". Del. Code Ann. tit. 8, § 154; N.Y. Bus. Corp. Law §102. "Stated capital" is further defined in the NYBCL as the "sum of (A) the par value of all shares with par value that have been issued, (B) the amount of the consideration received for all shares without par value that have been issued, except such part of the consideration therefor as may have been allocated to surplus in a manner permitted by law, and (C) such amounts not included in clauses (A) and (B) as have been transferred to stated capital, whether upon the distribution of shares or otherwise, minus all reductions from such sums as have been effected in a manner permitted by law." N.Y. Bus. Corp. Law §102.

⁵ See DEL. CODE ANN. tit. 8, § 170 and N.Y. Bus. Corp. § 510 (stating that, in case there is no surplus, dividends may be paid out of the corporation's "net profits for the fiscal year in which the dividend is declared and/or the preceding fiscal year").

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payments. For example, some charters may require that dividends only be paid out of “funds legally available” (or words to that effect), and Delaware courts have said that a similar requirement would be implied by law, even if a charter does not contain that language.⁶

When faced with a situation where the corporation may not meet the legal requirements for payment of a previously-declared dividend, the board of directors should consider moving the record date (if it has not already occurred) and the payment date, if doing so is not prohibited by the corporation’s organizational documents.⁷ On the other hand, if the record date has already occurred, the limitations discussed above may prohibit the corporation from paying the dividend on the payment date, in which case payment will have to be postponed until the corporation can meet the surplus test (or one of the exceptions) and any additional requirements set out in its organizational documents.

As a result, before proceeding with a dividend payment, a board of directors should consider its options and examine both the applicable law and the corporation’s organizational documents to ensure that payment is not prohibited.

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If you have any questions about the issues addressed in this memorandum, or if you would like a copy of any of the materials mentioned in it, please do not hesitate to call or email authors Helene Banks at 212.701.3439 or hbanks@cahill.com; or Yekaterina Fomitcheva at 212.701.3199 or yfomitcheva@cahill.com; or email publications@cahill.com.

⁶ See, e.g., *SV Inv. Partners, LLC v. ThoughtWorks, Inc.*, 7 A.3d 973, 990 (Del. Ch. 2010) (holding that, if the words “funds legally available” were omitted from a corporation’s charter, “a comparable limitation would be implied by law”).

⁷ See DEL. CODE ANN. tit.8, §213 and N.Y. Bus. Corp. §604 (setting out the requirements for fixing a record date).