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Corporations—Status of Nonvoting Stock in Nebraska

The Supreme Court of Nebraska has never had occasion to determine whether or not nonvoting preferred stock may be issued by a corporation in this state. The answer to this problem must depend upon the meaning of Article 12, section 5 of the Nebraska Constitution, which states:

The Legislature shall provide by law that in all elections for directors or managers of incorporated companies every stockholder shall have the right to vote in person or proxy for the number of shares owned by him, for as many persons as there are directors or managers to be elected or to cumulate said shares and give one candidate as many votes as the number of directors multiplied by the number of his shares shall equal, or to distribute them upon the same principle among as many candidates as he shall think fit, and such directors or managers shall not be elected in any other manner; except that any mutual or co-operative company or association may, in its articles of incorporation, limit the number of shares of stock any stockholder may own, the transfer of said stock, and the right of each stockholder or member to one vote only in the meetings of such company or association.

In compliance with this constitutional requirement, section 21-135 of the Revised Statutes of Nebraska,¹ was passed by the legislature. This statute, and the above mentioned section of the constitution, are capable of two interpretations: (1) that they simply secure to stockholders the right of cumulative voting, or (2) that they secure the right of cumulative voting plus a requirement that all stock issued by corporations in this state must have voting rights.²

Except for the last clause, Article 12, section 5 was originally a part of Article 11 of the Nebraska Constitution of 1875. This section was inserted to initiate cumulative voting and thus prevent the evil whereby a corporation could be controlled by a very small number of stockholders.³ Whether or not the framers of this section intended that it require all stock to have voting rights is unknown.

A more definite indication of the drafter's intentions was shown at the Constitutional Convention of 1919 and 1920, at which time the last clause of section 5 was added. Mr. Anderson, a delegate who had moved to strike section 5 from the new constitution, stated:

¹ That section states: "In all elections for directors of any company operating or organized under this act, every stockholder shall have the right to vote in person or by proxy, for the number of shares of stock owned by him, for as many persons as there are directors to be elected, or to cumulate said votes and give one candidate as many votes as the number of directors multiplied by the number of his shares of stock shall equal, or to distribute them upon the same principle among as many candidates as he shall think fit, and such directors shall not be elected in any other manner."

² See 25 Neb. L. Rev. 190 (1945).

³ 3 Debates and Proceedings in the Nebraska Constitutional Conventions of 1871 and 1875 (Vol. 13 Neb. State Hist. Soc. Pub., Ser. II, Vol. VIII) 103.

. . . there will undoubtedly be many times in the future when it will be beneficial, not only to the corporation itself, but to the general conduct of business and general welfare to have corporations that might issue preferred stock without power to vote . . . [Y]ou compel the Legislature to say that every share of preferred stock shall have equal voting power with every share of common stock.⁴

His motion was defeated and section 5 was adopted in the same form that prompted Mr. Anderson's objection.

In 1941 a subcommittee of the Nebraska State Bar Association drafted the present general corporation law of this state. In discussing a section of that law,⁵ which gives corporations very broad powers, the chairman of the subcommittee stated, "It does not permit the issuance of noper, nonvoting, noncumulative shares."⁶ Since that section when read alone would certainly not yield itself to such an interpretation, the subcommittee must have assumed that the issuance of nonvoting stock was prohibited by the Nebraska Constitution. Such an assumption seems to be generally accepted by the attorneys of this state at the present time.

The Nebraska constitutional provision was taken from Article 11, section 3 of the Illinois Constitution of 1870.⁷ That state has construed its constitutional provision as prohibiting the issuance of nonvoting stock in *People ex rel. Watseka Telephone Co. v. Emmerson*.⁸ In that case a corporation sought to increase its capital stock and wished to do so through the issuance of nonvoting preferred stock. The secretary of state refused to issue a certificate allowing the increase in capital stock because of the nonvoting provision. The court upheld the action of the secretary of state since it felt the constitution required that all stock must have voting privileges.⁹

⁴ 2 Proceedings of the Nebraska Constitutional Convention of 1919 and 1920, 1751.

⁵ Neb. Rev. Stat. § 21-121 (1943) provides: "Every corporation operating or organized under this act shall have power to issue one or more classes of stock or one or more series of stock within any class thereof, and in such series and with such designations, preferences and relative, participating, optional or other special rights, and qualifications, limitations or restrictions thereof, as shall be stated and expressed in the articles of incorporation or of any amendment thereto, or in the resolutions providing for the issue of such stock adopted by the board of directors pursuant to authority expressly vested in it by the provisions of the articles of incorporation or of any amendment thereto. The power to increase or decrease or otherwise adjust the capital stock as in this act elsewhere provided shall apply to all or any such classes of stock."

⁶ 21 Neb. L. Rev. 224 (1942).

⁷ Op. cit. supra note 3, at 105.

⁸ 302 Ill. 300, 134 N.E. 707 (1922).

⁹ Illinois had a statute similar to § 21-121 of the Nebraska Revised Statutes. It provided that stock may be divided ". . . into such classes, with such preferences, rights, values and interests as may be provided in the articles of incorporation, or any amendment thereof."

In reaching this decision the Illinois court relied on *Brooks v. State ex rel. Richards*¹⁰ in which the Supreme Court of Delaware construed a provision of the Delaware Constitution¹¹ (repealed by amendment in 1903) which was similar to Article 11, section 3 of the Illinois Constitution. The Delaware court held that the nonvoting provisions of the defendant corporation's preferred stock violated the Constitution and therefore preferred stockholders were entitled to vote.

Of course, the mere fact that Nebraska adopted Article 12, section 5 of its constitution from the Illinois Constitution does not bind the Nebraska court to interpret that section in accord with Illinois. However, the corporations division of the office of Secretary of State of Nebraska follows the Illinois interpretation and in the past has not allowed the issuance of nonvoting stock. Thus, although the question has never been expressly answered by the Nebraska Supreme Court, it appears to have been the general understanding that nonvoting stock cannot be issued in Nebraska.

In view of this background the recent Nebraska case of *E. K. Buck Retail Stores v. Harkert*¹² comes as somewhat of a surprise. In that case Earl Buck and E. K. Buck Retail Stores owned 40% of the stock of Harkert Houses, a Nebraska corporation. Walter Harkert together with his wife owned the remaining 60% of the stock in the company. At the time Buck acquired his interest in the corporation, he and Harkert entered into an agreement, supported by valid consideration, whereby the corporation would have a board of directors made up of four members, two of which were to be named by Buck, and the other two to be named by Harkert. Thus, the owners of 40% and 60% of the stock respectively had equal voting rights. This voting agreement was to remain in effect although the percentage of stock owned by either party might change. Buck brought action against Harkert for a declaratory judgment to determine the validity of the voting agreement. The defendant contended that the agreement was in violation of Article 12, section 5 of the Constitution, and section 21-135 of the Revised Statutes of Nebraska.

The court held that the agreement was not in violation of the constitution or the statute, and was therefore binding upon the parties. Such agreements, the court said, are valid where they work no fraud upon creditors or other stockholders and where they violate no statute or recognized public policy.

The court did not pass directly upon the question of the issuance of nonvoting stock. However, it did interpret Article 12, section 5 of

¹⁰ 3 Boyce (Del) 1, 79 Atl. 790 (1911).

¹¹ In all elections for directors or managers of stock corporations each stockholder shall be entitled to one vote for each share of stock he may hold. Del. Const. Art. 9, § 6 (1897).

¹² 157 Neb. 867, 62 N.W.2d (1954).

the Constitution, and section 21-135 of the Nebraska Revised Statutes. In reference thereto the court stated that the purpose of the constitutional provision and the statute was to insure the right of cumulative voting in order to secure to minority stockholders a greater voice in the management of corporate business, and a corporation cannot, through its articles of incorporation, by-laws, or acts of its directors, deprive its stockholders of this right. Justice Carter went on to say:

But such provision does not purport to limit the right of the stockholder to contract with reference to his stock. It grants him a right or privilege which he may or may not exercise as he sees fit, but it is one of which the corporation or any agency thereof cannot deprive him. Neither the constitutional provision nor the statute purports to limit the right of the stockholder to contract with other stockholders with respect to such rights.

It should be noted that the right of the stockholder which the court talked about was the right of cumulative voting. Thus, the question as to whether all stock must be voting stock is still unanswered. However, if by so construing the constitution the court intended to hold that Article 12, section 5, and section 21-135 of the Nebraska Statutes have only one purpose, that being to secure to the stockholders the right of cumulative voting, another section of the Nebraska corporations law¹³ would allow nonvoting stock to be issued. Furthermore, if a stockholder is free to contract with other stockholders in regard to his voting rights after the issuance of the stock, there seems to be no good reason why he should not be free to contract in regard to the same rights at the time the stock is issued. The purchase of a stock certificate which states on its face that the owner has no voting rights would amount to nothing more than a contractual agreement between the purchaser and the rest of the stockholders in the corporation.

In reaching its decision in *Buck v. Harkert*, the Nebraska court cited *State ex rel. Frank v. Swanger*,¹⁴ in which the Supreme Court of Missouri construed a constitutional provision of that state¹⁵ which is similar to Article 12, section 5 of the constitution of Nebraska. In that case the Missouri Secretary of State had refused to issue a certificate of incorporation to the incorporator because its proposed articles of incorporation declared that preferred stock was to be nonvoting. The court held that the Secretary of State had wrongfully withheld the certificate of incorporation. Referring to the provision in the Missouri constitution, the court stated:

¹³ See note 5 supra.

¹⁴ 190 Mo. 561, 89 S.W. 872 (1905).

¹⁵ In all elections for directors or managers of any incorporated company, each shareholder shall have the right to cast as many votes in the aggregate as shall equal the number of shares so held by him or her in said company. Mo. Const. Art 12, § 6 (1890).

Its purpose was to introduce the principle of cumulative system of voting in elections of stockholders so as to secure the minority of stockholders a voice in the management of the affairs of the Company in proportion to the number of his shares, in lieu of the common-law right to one vote, irrespective of the number of shares held by him. . . . Properly understood, we think section 6, article 12, of the Constitution means only that every stockholder entitled to vote at any corporate election is entitled to vote his share on the cumulative plan, but does not mean that the stockholders themselves in the organization of the company may not voluntarily agree that certain preferred stock shall be issued and that the holders thereof shall not have the right vote.

If the Nebraska court cited the Missouri case for the proposition that the sole purpose of such a constitutional provision is to guarantee the right of cumulative voting, then it has in effect decided that nonvoting stock may be issued by a Nebraska corporation.

Although the right of a corporation to issue nonvoting preferred stock may be in the public interest, it seems doubtful that Article 12, section 5 of the Nebraska Constitution was intended to be given such an interpretation. The plain meaning of that section seems to prohibit the issuance of such stock. If the constitutional provision was intended to allow nonvoting stock, the words "every stockholder entitled to vote" should have been used rather than the all inclusive words "every stockholder." The plain meaning of the provision, when coupled with the available legislative history of that provision, the Illinois interpretation of an identical provision, the administrative interpretation, and what appears to be settled practice in this state, presents a very strong argument against interpreting section 5 to allow the issuance of nonvoting stock. Therefore, despite the holding in *Buck v. Harkert*, it seems questionable whether the Supreme Court of Nebraska will allow the issuance of nonvoting stock in this state.

CLAIRE D. JOHNSON, '56