

Louisiana Law Review

Volume 16 | Number 3

April 1956

Corporations - Voting Rights - Classification of Board to Defeat Cumulative Voting

James M. Dozier

Repository Citation

James M. Dozier, *Corporations - Voting Rights - Classification of Board to Defeat Cumulative Voting*, 16 La. L. Rev. (1956)

Available at: <https://digitalcommons.law.lsu.edu/lalrev/vol16/iss3/11>

This Note is brought to you for free and open access by the Law Reviews and Journals at LSU Law Digital Commons. It has been accepted for inclusion in Louisiana Law Review by an authorized editor of LSU Law Digital Commons. For more information, please contact kreed25@lsu.edu.

CORPORATIONS — VOTING RIGHTS — CLASSIFICATION OF BOARD
TO DEFEAT CUMULATIVE VOTING

Two recent decisions involving the privilege of cumulative voting and its relationship to classification of directors, rendered by Ohio and Illinois courts, are worthy of note in connection with the Louisiana law on the subject. In *Humphreys v. Winous Co.*¹ the stockholders of an Ohio corporation adopted a resolution amending the code of regulations (by-laws) of the corporation so as to provide a classified board of directors consisting of three persons, one to be elected each year for a three-year term.² Minority stockholders representing more than forty percent of the stock sought a declaratory judgment to determine the validity of the resolution. The trial court rendered judgment upholding the resolution. On appeal, *held*, reversed. Although Ohio statutory law³ then permitted unlimited classification of directors, to allow the election of a single director each year as sought to be done in the instant case would vitiate entirely the right to cumulative voting which is made mandatory by statute in Ohio. The Legislature could not have intended the permission to classify directors to nullify completely the cumulative voting right; therefore the by-law provision in question was invalid.

In *Wolfson v. Avery*⁴ the board of directors of Montgomery Ward & Company, an Illinois corporation, was composed of nine members, divided into three classes of three members each. Each class was to be elected annually for a three-year term. The statutory law of Illinois permitted classification of a board of directors of nine or more members.⁵ However, the Illinois Constitution⁶ guarantees to stockholders the right of cumulative voting in the election of directors. Plaintiff shareholders alleged that the statute permitting classification was contrary to the

1. 57 Ohio Op. 44, 125 N.E.2d 204 (Ohio App. 1955).

2. Classification of the board of directors and "staggering" of the terms of the directors is a system by which the total number of directors are divided into several groups, called classes and designated Class A directors, Class B directors, Class C directors, etc. The terms of Class A directors expire at the end of the first year, those of Class B directors at the end of the second year, those of Class C at the end of the third year, etc. Thereafter, the term of each director will be as many years as there are classes, so that each year the directors of a different class, and only the directors of that class, are elected. Thus, the terms of the directors are said to be "staggered." BALLANTINE, CORPORATIONS 404 (rev. ed. 1946); Comment, 22 U. CHI. L. REV. 751, 754 (1955).

3. Ohio Rev. Code § 1701.64 (Page 1953).

4. 126 N.E.2d 701 (Ill. 1955).

5. ILL. BUS. CORP. ACT § 35.

6. ILL. CONST. art. XI, § 3 (1870).

constitutional provision. Judgment was rendered for the plaintiff in the trial court. On appeal, *held*, affirmed. Since classification of the board would greatly impair the constitutional guaranty of cumulative voting, the statute permitting classification was invalid.

Cumulative voting permits a stockholder to cast as many votes as he has shares, multiplied by the number of directors to be elected. He may cast all of his votes for one candidate or distribute them among two or more candidates.⁷ The purpose of cumulative voting is to afford the minority stockholders an opportunity of representation on the board of directors.⁸ Without it, the holders of a bare majority of the shares could elect the entire membership of the board and exclude the minority from participation in the management of the corporation.⁹ Cumulative voting cannot be employed in any shareholder action other than the election of directors;¹⁰ neither can it be employed when only one director is to be elected.¹¹ Consequently, in order for cumulative voting to be effective, all the directors to be chosen at any particular meeting must be voted for collectively and not by individual elections.¹² As the number of directors to be chosen increases, so do the minority's chances to gain representation, for the number of votes necessary for election of one director decreases proportionately.¹³

Since cumulative voting is unknown at common law,¹⁴ the right can exist only where it is expressly provided by statute. State laws authorizing cumulative voting are of two types,

7. LA. R.S. 12:32B (1950); BALLANTINE, CORPORATIONS 404 (rev. ed. 1946); *Wright v. Central Calif. Water Co.*, 67 Cal. 532, 8 Pac. 70 (1885); *Pierce v. Commonwealth*, 104 Pa. St. 150 (1883).

8. *Maddock v. Vorclone Corp.*, 17 Del. Ch. 39, 147 Atl. 255 (1929); BALLANTINE, CORPORATIONS 404 (rev. ed. 1946).

9. BALLANTINE, CORPORATIONS 404 (rev. ed. 1946).

10. *Western Cottage Piano & Organ Co. v. Burrows*, 144 Ill. App. 350 (1908); *Bridges v. Staton*, 150 N.C. 216, 63 S.E. 892 (1909).

11. See *Wright v. Central Calif. Water Co.*, 67 Cal. 532, 8 Pac. 70 (1885). This was the basis of the decision in *Humphreys v. Winous Co.*, 57 Ohio Op. 44, 125 N.E.2d 204 (Ohio App. 1955).

12. *Ibid.*

13. BALLANTINE, CORPORATIONS 404 (rev. ed. 1946): "If there are five vacancies to be filled, each share of stock may be voted five times for one individual to fill one vacancy, instead of one vote per share for each of the five vacancies. If there are five directors to be chosen and one-fifth of the shares are voted for one nominee, he is practically assured of getting a place on the board, while if only three directors are to be chosen one-third of the shares would be required for the same assurance."

14. *In re Brophy*, 13 N.J. Misc. 462, 179 Atl. 128 (1935); *State ex rel. Swanson v. Perham*, 30 Wash.2d 368, 191 P.2d 689 (1948).

namely, "mandatory" and "permissive."¹⁵ Where the state constitution or statute is "mandatory," cumulative voting rights cannot be removed by charter or by-law provisions.¹⁶ On the contrary, where the state statute is "permissive," as in Louisiana,¹⁷ cumulative voting is authorized only if the charter or by-laws of the corporation provide for it,¹⁸ or in some cases, do not prohibit it.¹⁹ In states having "mandatory" provisions, certain means have been employed by the majority shareholders in an attempt to circumvent or nullify the requirement for cumulative voting.²⁰ For example, where the minority shareholders have already chosen their directors, board meetings are sometimes replaced by "informal discussions" among majority directors. In other instances, committees without minority representation are appointed by the board to perform acts of management. In small corporations, to the extent that it is legally possible to do so,²¹ the board may relinquish its policy-making powers to the officers of the corporation, thereby excluding the minority from participation in management. Again, if the majority has the power to remove directors without cause, it may seek to deprive the minority of its representation on the board by removing the director who was elected by the minority through cumulative voting.²² Through other devices, the majority may seek to prevent the minority group from effectively utilizing its privilege of cumulative voting. For example, a reduction of the number of directors to be elected will make it proportionately more difficult for the minority group to cumulate enough votes to elect a director.²³ Classification of the board with the resultant

15. BALLANTINE, CORPORATIONS 406 (rev. ed. 1946); Comment, 22 U. CHI. L. REV. 751 (1955).

16. See note 15 *supra*.

17. LA. R.S. 12:32B (1950).

18. See note 15 *supra*.

19. See, e.g., TEXAS BUS. CORP. ACT art. 2.29D, Texas Laws 1955, c. 64.

20. The devices listed here, which are used to effect this end, are discussed more fully in Comment, 22 U. CHI. L. REV. 751 (1955).

21. The directors cannot completely abdicate their authority to a committee or to the officers. *Sherman & Ellis, Inc. v. Indiana Mutual Casualty Co.*, 41 F.2d 588 (7th Cir. 1930), *cert. denied*, 282 U.S. 893 (1930).

22. Comment, 22 U. CHI. L. REV. 751, 752 (1955). There is authority, however, for the proposition that adoption of a cumulative voting provision will restrict a pre-existing power of removal without cause so as to prevent use of this device to deprive the minority of their representative on the board of directors. *In re Rogers Imports, Inc.*, 116 N.Y.S.2d 106 (Sup. Ct. 1952). In Louisiana a director elected by virtue of cumulative voting cannot be removed except for cause. LA. R.S. 12:34C(4) (1950): "If a director has been elected by the exercise of the privilege of cumulative voting, such director may not be removed under the provisions of this paragraph except for cause."

23. BALLANTINE, CORPORATIONS 404, n. 21 (rev. ed. 1946); Comment, 22 U. CHI. L. REV. 751, 754 (1955).

"staggering" of the terms of its members achieves a similar result, since it decreases the number of directors to be elected each year.²⁴

The instant cases involved attempts to classify the respective boards and "stagger" the terms of the directors so that only one-third of the board would be elected each year and the effect of cumulative voting neutralized or greatly diminished. It should be noted that in both cases the state corporation laws permitted classification of the board.²⁵ The Ohio court felt, however, that to permit classification where a three-man board was concerned would result in a violation of the more specific prohibition in its statutes against restricting or qualifying the right of cumulative voting.²⁶ It did not, it would seem, entirely invalidate the use of classification where its adoption would not completely nullify cumulative voting, because unlike the Illinois decision, only a *by-law* was invalidated and not the *statute* permitting classification. Thus by implication a fact situation such as found in the *Wolfson* case might be proper in Ohio.²⁷ On the other hand, the Illinois court went much further and invalidated its classification *statute* because under its Constitution²⁸ any impairment of the right to vote cumulatively was not allowed and

24. BALLANTINE, CORPORATIONS 404 (rev. ed. 1946); Comment, 22 U. CHI. L. REV. 751, 754 (1955). The effect of such reduction was cogently explained in the *Wolfson* case: "In an election of a full board of nine directors, the owners of 10 per cent of the stock voted, plus one share, could elect one out of the nine directors to be elected. On the other hand, if the board of directors is classified so that only three members are elected each year, it would require 25 per cent of the stock voted, plus one share, to gain a single seat on the board. Where all nine members are elected at once, a minority holding 49 per cent of the stock could elect four If only three members of the board are elected each year, however, the holders of 49 per cent would be able to elect only one director at each election, and could never have more than three directors on the board at one time It is evident therefore, that as the number of directors up for election decreases the number of share votes necessary to elect one director increases." *Wolfson v. Avery*, 126 N.E. 701, 704 (Ill. 1955), citing WILLIAMS, CUMULATIVE VOTING 48-49 (1951).

25. OHIO REV. CODE § 1701.64 (Page 1953); ILL. BUS. CORP. ACT § 35 (1933).

26. OHIO REV. CODE § 1701.58 (Page 1953).

27. This seems to be borne out by the change in the Ohio classification provision made in 1955 by the new Ohio Corporation Law which took effect after the *Winous* decision. OHIO REV. CODE § 1701.57(B) (Page, Supp. 1955). Under the new law, each class of directors must be comprised of no less than three directors each. Since the mandatory cumulative voting requirement is continued in effect, it would appear the Ohio Legislature intended that so long as classification does not do away with cumulative voting entirely, it is permissible. See *Final Report of the Corporation Law Committee of the Ohio Bar Association* following the new statutory section to the effect that the change was made to meet the objection that under the old law it was possible for a three-man board to be so classified that only a single director need be elected annually and he would in all cases be elected by a majority vote.

28. ILL. CONST. art. XI, § 3 (1870).

it had no doubt that classification of directors did that very thing.

Louisiana Revised Statutes of 1950 12:32B states that "the articles [of incorporation] *may provide* that in the election of directors each shareholder of record shall have the right" to vote cumulatively.²⁹ (Emphasis added.) Unlike the provisions in the instant cases, the privilege of cumulative voting is thus permissive and not mandatory. Since the privilege must be set out in the articles of incorporation, it may be granted or denied as the incorporators may originally desire or as the requisite number of shareholders may later determine when amending the articles. Furthermore, classification of directors, while not spelled out, is permitted by section 34 of the Louisiana Corporation Act.³⁰ Consequently classification schemes similar to either type adopted in the instant cases undoubtedly would be held valid in Louisiana. It stands to reason, that if the privilege of cumulative voting can be granted or denied *in toto*, a partial abridgement that might result from the proper adoption of a plan of classification could not be invalid. The sole statutory protection given to minority shareholders in Louisiana if cumulative voting is permitted is the prohibition against removal of a director elected by cumulative voting, except for cause.³¹ This, at least, would effectively bar the majority shareholders from excluding the minority shareholders from participation in management once the minority had elected its representatives. One other mode of protection for the minority having cumulative voting privileges suggests itself. The minority can insist at the time of incorporation or upon amendment of the articles that the articles provide a nearly unanimous vote be required to amend the articles with respect to the method of selection and changing the number of directors.³² True, this insistence

29. LA. R.S. 12:32B (1950).

30. See *id.* 12:34B, which provides in part: "The names, *classifications*, and terms of office of the first directors may be stated in the articles." (Emphasis added.) and *id.* 12:34C: "The number, *classifications*, qualifications, terms of office, manner of election, time and place of meeting, and the powers and duties of the directors may, subject to the provisions of this Chapter, be prescribed by the articles or by-laws." (Emphasis added.)

31. *Id.* 12:34C(4).

32. A 95% requirement is suggested as probably being the safest provision. A lower one might permit the majority to muster enough votes to amend the articles; a requirement of unanimity might be challenged as invalid. However, a requirement of unanimity to abolish or restrict cumulative voting might be upheld by the court because it would not result in a stalemate of corporate action. LA. R.S. 12:42B (1950) authorizes any number over a majority that the incorporators may

may not be effective against majority determination to the contrary, but if the majority is willing initially to grant the privilege of cumulative voting, it should be willing to adopt some such provision in the articles to insure its continuation.

James M. Dozier, Jr.

CRIMINAL PROCEDURE — DEFENSE OF INSANITY — AN APPRAISAL
OF STATE V. WATTS

Prior to the enactment of the Code of Criminal Procedure of 1928 the plea of insanity was not a special plea. Rather, the defense of insanity was included under and tried with the general plea of not guilty.¹ The Code, however, includes insanity as one of the four possible pleas to an indictment; it provides that a defendant who intends to rely upon insanity at the time of the commission of the crime must file a special plea to that effect.² It provides also that all pleas must be entered at arraignment, and thereafter it is within the trial judge's discretion to permit changes of pleas.³ Shortly after the adoption of the Code the Supreme Court interpreted the articles relating to the newly established insanity plea, in the case of *State v. Watts*.⁴ In that case the defendant had pleaded not guilty at arraignment. On the day of the trial, thirteen days later, he moved to change his plea to insanity at the time of the commission of the homicide. Holding that the motion came too late, the trial judge refused to permit the change and defendant was found guilty. The Supreme Court reversed on rehearing, and held that the defense could properly be pleaded even on the day of trial, stating that "the plea of insanity under these Code articles is a matter of right

choose to require to amend: "[A]n amendment altering the articles may be adopted by the vote of the holders of two-thirds of the voting power of all shareholders entitled under the articles to vote, or by such larger or smaller vote, not less than a majority, as the articles may require." (Emphasis added.)

1. *State v. Brodes*, 156 La. 428, 100 So. 610 (1924).

2. LA. R.S. 15:261 (1950): "There are four kinds of pleas to an indictment:

"(1) Guilty

"(2) Not guilty

"(3) Former jeopardy

"(4) Insanity."

3. LA. R.S. 15:255 (1950): "Defendant must plead when arraigned; and if he refuse, or stand mute, the plea of not guilty shall be entered for him."

LA. R.S. 15:265 (1950): "The defendant may at any time, with the consent of the court, withdraw his plea of not guilty and then set up some other plea or demur or move to quash the indictment."

4. 171 La. 618, 131 So. 729 (1930).