Michigan Law Review

Volume 47 | Issue 4

1949

CORPORATIONS-SEPARATION OF THE VOTING POWER FROM LEGAL AND BENEFICIAL OWNERSHIP OF CORPORATE STOCK

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CORPORATIONS—SEPARATION OF THE VOTING POWER FROM LEGAL AND BENEFICIAL OWNERSHIP OF CORPORATE STOCK—The Supreme Court of Michigan recently decided the case of *Ecclestone v. Indialantic, Inc.*,[1] the important facts being as follows: in June, 1942, defendant Emmons, owner of 451 shares of the common stock of Indialantic, Inc., a Florida corporation, transferred his entire holding to the Detroit Orthopedic Clinic in payment of an antecedent debt, reserving to himself, however, the sole right to vote the stock until the assets of the corporation were substantially liquidated. In March, 1946, with notice of this reservation of the right to vote, the plaintiff purchased all of these shares from the Clinic and thereby acquired, when added to others previously purchased, ownership of a majority of the outstanding shares of the Indialantic corporation. Defendant Emmons having refused to cancel his right to vote and defendant Indialantic, Inc., having declined to transfer the stock without reservation of the voting power, plaintiff brought this suit in chancery for a declaration of his right to vote the stock in question. On appeal, the lower court's dismissal of the plaintiff's bill was affirmed on the following grounds: (1) that this separation of the voting power from stock ownership was justified by the presence of a property interest to be conserved and a definite policy of the corporation to be carried out; and (2) that the services rendered by defendant Emmons were so valuable and important to the welfare of the corporation, and their continuation so desirable, that the power to vote, being beneficial not only to Emmons but also to the corporation itself, was a power coupled with an interest which was not affected by the sale of the stock to the plaintiff.

The validity of voting agreements, using the term in its broadest sense to include proxies, pooling agreements, voting combinations and voting trusts, has been a major problem in the courts for nearly three-quarters of a century. To say that today the conflict and confusion of the decisions are justifiable as a reasonable difference of judicial opinion is an unwarranted rationalization, especially in view of the fact that a judicially legislated "public policy" is the principal source of trouble.

It is not within the scope of this comment to consider the validity of voting agreements in general. Too many factors are involved. For

[1] 319 Mich. 248, 29 N.W. (2d) 679 (1947).

example, much may depend on who is challenging the validity of a particular agreement, whether a party thereto or a stockholder outside the agreement;[2] statutes in force in the particular jurisdiction are of course of the utmost importance;[3] defective instrumentation or lack of consideration may be cause for invalidating an agreement;[4] the purpose or object for which a voting agreement was made may be decisive, as, for instance, where fraud or other illegal action is contemplated in contrast to action beneficial to the corporation or the stockholders as a whole;[5] whether an agreement purports to be revocable or irrevocable, and whether there has been a separation of the voting power from stock ownership or merely an advance commitment of the vote, must be considered in the light of the "public policy" of the jurisdiction toward the particular voting agreement. Therefore, except for purposes of background, comparison or analogy, only those voting agreements which purport to separate irrevocably the voting power from both legal and beneficial ownership of corporate stock, which are not defective in form or for want of consideration, which do not involve actual fraud or other illegal purpose and whose validity is challenged in a controversy between the parties thereto or their privies, will be considered.

I

"Public Policy"

Initially, the rapid growth of the corporate form of business, the economic evils and benefits of separating the right to vote from legal or beneficial ownership of corporate stock, and the practical business need for some sort of voting control device could not readily be foreseen. Therefore, the courts understandably looked with distrust upon an agreement which made possible the complete control of property in a business enterprise without the incidents of risk normally assumed by the entrepreneur. In the earlier cases this distrust usually resulted in sweeping declarations of a "public policy" which condemned virtually all separations of voting power from either legal or beneficial ownership

[2] White v. Thomas Inflatable Tire Co., 52 N.J. Eq. 178, 28 A. 75 (1893); Chapman v. Bates, 61 N.J. Eq. 658, 47 A. 638 (1900); Mackin v. Nicollet Hotel, Inc., (C.C.A. 8th, 1928) 25 F. (2d) 783 at 788; Faulds v. Yates, 57 Ill. 416 (1870); Tuller, "Voting Agreements of Stock," 44 AM. L. REV. 663 at 682 (1910).

[3] See 5 FLETCHER, CYC. CORP., perm. ed., § 2080, note 4 (1931), for compilation of states having statutes authorizing voting trusts. In addition, many states have statutes limiting the duration of proxies. See also, Brigers v. First Nat. Bank, 152 N.C. 282, 67 S.E. 770 (1910); Simpson v. Neilson, 77 Cal. App. 297, 246 P. 342 (1926).

[4] Warren v. Pim, 66 N.J. Eq. 353, 59 A. 773 (1904); 5 FLETCHER, CYC. CORP., perm. ed., § 2079 (1931).

[5] Reed v. Bank of Newburgh, 6 Paige (N.Y.) 337 (1837); McClean v. Bradley, (C.C.A. 6th, 1924) 299 F. 379; 5 FLETCHER, CYC. CORP., perm. ed., §§ 2081-2084 (1931).

of stock, not because the voting agreement or trust itself was invalid but rather because of the injurious effect such an agreement was supposed to have on the rights of other stockholders and on trade and the public welfare in general.[6]

The reason most frequently given was that a sort of fiduciary relationship exists between stockholders and, consequently, each stockholder is entitled to have the benefit of the judgment of every other stockholder and to have the affairs of the corporation managed by responsible persons who stand to lose directly from faulty or ill-advised decisions on corporate policy or planning.[7] In theory this reasoning is perhaps tenable, but in practice it deteriorates, primarily because of the known fact that a very substantial percentage of stockholders, especially those in large corporations with capital stock widely held, do not vote at stockholders' meetings either in person or by proxy.[8] But the reasoning further breaks down because it fails to recognize the possibility that a voting agreement may be beneficial to all the stockholders. For example, it may provide a stabilizing influence and make feasible long-range planning and policy, or it may serve to persuade creditors of a corporation in financial distress to forsake the race of diligence in return for a voice in the management.[9]

A second reason sometimes offered was that an irrevocable separation of the voting power from stock ownership constitutes an unlawful restraint on alienation of property.[10] This appears to be a doubtful conclusion in both law and fact and was never seriously considered. Still another reason given, when the facts of the case justified it, was that a stockholder could not sell his right to vote for a consideration personal to himself or, for the same consideration, agree to cast the vote himself.[11] An analogy has been drawn between sale of the vote in corporate elections and the sale of the vote by electors in a democracy.[12] However, the writer has been unable to find a single case in which this doctrine was essential

[6] Shepaug Voting Trust Cases, 60 Conn. 553, 24 A. 32 (1891); Harvey v. Linville Improvement Co., 118 N.C. 693, 24 S.E. 489 (1896); State v. Standard Oil Co., 49 Ohio St. 137, 30 N.E. 279 (1892); 2 THOMPSON, CORPORATIONS, 3d ed., § 991 (1927); Wormser, "The Legality of Corporate Voting Trusts and Pooling Agreements," 18 YALE L.J. 123 (1918).

[7] Shepaug Voting Trust Cases, 60 Conn. 553, 24 A. 32 (1891); Tuller, "Voting Agreements of Stock," 44 AM. L. REV. 663 at 666 et seq. (1910); Smith, "Limitations on the Validity of Voting Trusts," 22 COL. L. REV. 627 (1922).

[8] Mackin v. Nicollet Hotel, Inc., (C.C.A. 8th, 1928) 25 F. (2d) 783 at 786; Hornstein, "Corporate Control and Private Property Rules," 92 UNIV. PA. L. REV. 1 (1943).

[9] Mobile &. O. R. Co. v. Nicholas, 98 Ala. 92, 12 S. 723 (1892).

[10] Moses v. Scott, 84 Ala. 608, 4 S. 742 (1887).

[11] Dieckmann v. Robyn, 162 Mo. App. 67, 141 S.W. 717 (1911); Brady v. Bean, 221 Ill. App. 279 (1921); Smith v. San Francisco & N. P. Ry. Co., 115 Cal. 584, 47 P. 582 (1897); 5 FLETCHER, CYC. CORP., perm. ed., § 2065 (1931).

[12] Baldwin, "Voting Trusts," 1 YALE L.J. 1 (1891).

to the decision. Invariably present were other grounds such as fraud, illegal purpose or illegal restriction on the discretion of the directors, on which the decision could have been based. Furthermore, the analogy itself is faulty, not only because democracy is not inherent in private corporations, but also because the right to vote in corporate elections, being the right to control the use of corporate property, is a property right and as such should be subject to property law and not necessarily to election law.

The rising tide of business necessity wore into the foundations of this "public policy" barrier erected in the earlier cases, and it soon became apparent that there was no obvious and overwhelming reason for judicially condemning virtually all separations of voting power from legal or beneficial ownership as invalid per se.[13] In some jurisdictions previous broad declarations of "public policy," to a large degree dicta, were modified. As other jurisdictions ruled on the question for the first time, the weight of authority became, at least where the voting power was separated from only the beneficial ownership of stock, that the separation of the voting power is justified when there is a "property interest to conserve, some definite policy in the interest of the corporation to be carried out, some beneficial interest of the stockholders to be served, or some purpose not unlawful of an advantageous character to the stockholders to be effectuated."[14]

It is essential to recognize, however, in what situations the attack on this "public policy" made progress. When the old common law restriction on voting by proxy was eliminated by statute, no questions of policy against separating voting power from legal or beneficial ownership of stock were raised.[15] Nor were such "policy" questions raised when voting combinations or pooling agreements, not involving a transfer of the legal ownership of stock, were upheld on the theory that stockholders could validly unite and pool their strength by committing their vote in advance.[16] The principal inroad was made in the field of voting trusts where, in addition to the right to vote, the legal title to the stock is transferred to the trustee, thereby severing the voting power from the beneficial ownership only. Here the argument has often prevailed that "public policy," if any, is against separating the right to vote

[13] Mackin v. Nicollet Hotel, Inc., (C.C.A. 8th, 1928) 25 F. (2d) 783; Carnegie Trust Co. v. Security Life Ins. Co., 111 Va. 1 at 20, 68 S.E. 412 (1910).

[14] Boyer v. Nesbitt, 227 Pa. 398 at 402-403, 76 A. 103 (1910).

[15] General acceptance of the theory that the proxyholder is merely an agent of the stockholder eliminated the argument that a separation of the voting power is authorized by a statute granting the right to vote by proxy.

[16] The stockholder was considered as personally exercising his right to vote even though he had committed himself in advance to vote as the majority of the stockholders in the pool should decide. See, Smith v. San Francisco & N.P. Ry. Co., 115 Cal. 584, 47 P. 582 (1897); White v. Snell, 35 Utah 434, 100 P. 927 (1909); 46 MICH. L. REV. 70 (1947).

from the legal ownership, i.e., from the stock itself, and not against separating the right to vote from beneficial ownership alone.[17] Whether or not this distinction has any merit in so far as non-statutory "public policy" is concerned, it does harmonize with the contention that strict construction of a statute which gives to each "stockholder" the right to vote does not permit finding a legislative intent that the right to vote may be separated from the legal ownership of stock and exercised by one not a "stockholder"; for a voting trustee, having legal title to stock under a valid voting trust, does qualify as a "stockholder."[18] It has been forcefully argued that the conflict in voting trust cases over the question of "public policy" lies primarily in dicta and that almost all these cases can be reconciled on their facts (e.g., fraud or illegal purpose present) or on the basis of statutory construction.[19] It is sufficient for present purposes to note that in the absence of statutory authorization some courts have upheld voting trusts on the theory of the distinction set out above, viz., that "public policy" is not against the separation of the voting power from the beneficial ownership of stock but rather against separation from the stock itself;[20] that other courts have upheld voting trusts on the theory that a valid trust has been created against which there is no opposing "public policy;"[21] and that still other courts have made no distinction between the form of stock ownership from which the voting power is separated and have struck down voting trusts with the expression, though perhaps dictum, of a hostile "public policy."[22]

In the principal case the court made no attempt to categorize the voting agreement in issue. Conceivably it could be termed a reservation of the voting power by defendant Emmons, a sale of the voting power by the Detroit Orthopedic Clinic or an irrevocable proxy granted by the clinic; but in whatever category it is placed, the net result is that the voting power has been, for all practical purposes, permanently separated from both legal and beneficial ownership of the stock. The real difficulty in the principal case is to discover the court's conception of "public policy" in Michigan toward such voting agreements.[23] Although not definitely

[17] Clark v. Foster, 98 Wash. 241, 167 P. 908 (1917); 5 FLETCHER, CYC. CORP., perm. ed., § 2065 (1931).

[18] Arkansas Valley Sugar Beet and Irrigated Land Co. v. Ft. Lyon Canal Co., (C.C.A. 8th, 1909) 173 F. 601; Babcock v. Chicago Rys. Co., 325 Ill. 16, 155 N.E. 773 (1927); Clark v. Foster, 98 Wash. 241, 167 P. 908 (1917).

[19] Carnegie Trust Co. v. Security Life Ins. Co., 111 Va. 1, 68 S.E. 412 (1910); Mackin v. Nicollet Hotel, Inc., (C.C.A. 8th, 1928) 25 F. (2d) 783 at 787; 5 FLETCHER, CYC. CORP., perm. ed., § 2078 (1931).

[20] See note 17, supra.

[21] Brightman v. Bates, 175 Mass. 105, 55 N.E. 809 (1900).

[22] See note 6, supra.

[23] It is quite possible that there was a conflict of laws question in the principal case and that the law and "public policy" of Florida should govern, but the point was not considered by the court.

stated, the tone of the decision and the textual material quoted therein indicate that there is a "public policy" in Michigan against the separation of the right to vote from the beneficial ownership of stock but that such a separation is justified when there is a property interest to conserve or some definite policy in the interest of the corporation to be carried out. In other words, there is a rebuttable presumption against the validity of such an agreement which must be overcome by the party asserting its validity.

In justifying the separation of the voting power in the principal case, the court found such a "property interest" and a "definite policy." Exactly what property interest there was to be conserved is not clear. The opinion suggests that if the corporation was indebted to defendant Emmons for services rendered prior to the time the agreement reserving the power to vote was executed, then retention of the voting power was permissible as security for such creditor's rights. The record indicates that prior to the present litigation defendant Emmons had been compensated for services rendered before the agreement was executed. The opinion also suggests that if defendant Emmons performed services for the corporation subsequent to the execution of the agreement, reservation of the voting power was permissible as security for payment therefor. Future compensation for services yet to be rendered is certainly a new concept of a "property interest" to be conserved, and one of dubious merit. With respect to the "definite policy" of the corporation to be carried out, both the opinion and the record fail to indicate anything more than that defendant Emmons had performed valuable services for the corporation in the past. On this showing, surely it would be difficult to contend that either a property interest to be conserved or a definite policy of the corporation to be carried out "affirmatively appears,"[24] so as to overcome the presumption of invalidity. Has the court merely paid lip-service to a questionable "public policy" now too well established to be ignored?

In developing its opinion the court quoted considerable textual material which pointed up the modern tendency to take a more liberal attitude toward voting trusts and to condition their validity on the existence of a legitimate purpose or objective rather than on an immutable "public policy." The fact remains, however, that a valid voting trust cannot be created without legal title to the stock being transferred to the trustee.[25] Unless the Michigan Supreme Court is willing to assert that the separation of legal ownership from voting power is immaterial to "public policy," the policy implications in voting trust cases do not lend

[24] Cone v. Russell, 48 N.J. Eq. 208 at 216, 21 A. 847 (1891).

[25] This is a general rule of trust law, but, in addition, both Michigan and Florida statutes authorizing voting trusts require that legal title to the stock pass to the trustee. See, Mich. Stat. Ann. (1937) § 21.34; Fla. Stat. (1941) § 612.19.

support to a decision sustaining a voting agreement similar to the one found in the principal case.

Assuming that the legislature has not indicated a policy restricting separation of the voting power from legal or beneficial ownership of corporate stock, is there any justification today for a condemning "public policy" being recognized independently by the judiciary? It is submitted that there is not, for unless the reasons therefor are clear and convincing, courts are not warranted in evolving new or retaining old concepts of "public policy" on which to base their decisions. Considering the weight of judicial opinion supporting agreements which separate the voting power, the practical need for some sort of voting control device, the action of many state legislatures sanctioning voting trusts,[26] the ability to create irrevocable proxies, and the common statutory provisions for nonvoting classes of corporate stock, one becomes very doubtful whether a "public policy" exists which is so obvious and overwhelming as to warrant independent judicial recognition. This would seem to be true whether or not the voting power is separated from legal ownership in addition to beneficial ownership, unless the transfer of the bare legal title to the person having the right to vote is an element of form important enough to be transformed into a matter of "public policy." Although the writer has been unable to find another case which squares with the principal case involving a sale of the complete legal and beneficial ownership of corporate stock while reserving the right to vote, it is believed that the court reached the correct decision, but for improper reasons. Should not the court have reasoned that the power to vote in corporate elections is a power or a property right[27] which may exist independently of the stock from which it arises, that there is no "public policy" against separating the right to vote from stock ownership except one expressed by the legislature, and that the voting agreement between defendant Emmons and the Clinic, neither lacking in consideration nor tainted with fraud or other illegal purpose, is valid?

II

Power Coupled With An Interest

In addition to the "public policy" argument, plaintiff asserted that the right of defendant Emmons to vote the stock in question was a mere proxy and, as such, revocable. Without specifically deciding whether the agreement in the principal case constituted a proxy, the court answered plaintiff's argument by holding that the power of defendant Emmons

[26] See note 3, supra.

[27] Brown v. McLanahan, (C.C.A. 4th, 1945) 148 F. (2d) 703; Carnegie Trust Co. v. Security Life Ins. Co., 111 Va. 1 at 27, 68 S.E. 412 (1910); Hornstein, "Corporate Control and Private Property Rules," 92 UNIV. PA. L. REV. 1 (1943).

to vote was a power coupled with an interest and therefore an exception to the general rule that agencies, including proxies, are revocable. But what is such an interest?

In *Arcweld Manufacturing Co. v. Burney*,[28] cited in the principal case, two such interests were described, the first being "an interest in the subject or thing itself upon which the power is to be exercised,"[29] and the second being a security interest usually given to provide protection for money advanced or obligations incurred by the agent. The *Arcweld* case was reviewed and expanded by the Washington Supreme Court in a subsequent decision[30] involving a two-party agreement creating mutual proxies to take effect on death and executed for the purpose of securing the control of the corporation to the survivor. Referring to the exact wording of the *Arcweld* case as quoted above, the court made a tenuous distinction between an interest in the "subject" and an interest in the "thing itself" upon which the power is to be exercised, stating that either interest is sufficient to support an irrevocable proxy. Under the facts of the later decision, the surviving party to the voting agreement, while not having a legal interest in the "thing itself," the stock, was found to have an interest in the "subject" on which the power was to be exercised, which subject was described as the intangible voting rights plus consequent control of the corporation. In addition, the scope of the security type interest which would support an irrevocable proxy was enlarged in the later decision so that it might be found in any situation where the purpose to be served by the exercise of the power is the protection or furtherance of the interest of the proxyholder; and under the facts of the later case, the proxyholder was found to have such a security interest since the power to vote was necessary to make the control of the corporation secure.

This extraordinary view adopted by the Supreme Court of Washington seems to have been employed by the Michigan Supreme Court in the principal case, although the later Washington decision was not cited. The net result of such a conception of a power coupled with an interest would seem to be, in so far as proxies are concerned, that whenever a proxy is supported by consideration and given for a purpose beneficial to the holder rather than merely for the purpose of authorizing the holder to express the view of the stockholder, then the proxy is coupled with an interest and irrevocable, even though not expressly declared to be irrevocable. Thus, as in the principal case, a proxy given for a consideration and for the purpose of securing to the holder his position in or remuneration from the corporation would be coupled with an interest and irrevocable. Under this concept the conventional view that an "interest" meant either a property right of the proxy holder in the stock

[28] 12 Wash. (2d) 212, 121 P. (2d) 350 (1942).
[29] Ibid. at 222.
[30] State v. Pacific Waxed Paper Co., 22 Wash. (2d) 844, 157 P. (2d) 707 (1945).

itself or security for money advanced by the holder[31] becomes wholly inadequate. And can we not take the final step and say that in any jurisdiction where the view of the Washington and Michigan Supreme Courts is adopted, the entire concept of a power coupled with an interest must be discarded in so far as corporate proxies are concerned? Can we not say that here again the court in the principal case has paid mere lip-service to a doctrine too well established to be ignored and has, in fact, reduced the problem of irrevocable proxies to one of ordinary consideration and intent of the parties to the agreement?[32]

III

Conclusion

The real problem in this branch of the law concerns the use of voting agreements as a means of concentrating economic power and perpetuating control over investment and utilization of corporate assets. No doubt certain restrictions on the separation of the voting power from legal or beneficial ownership of corporate stock are called for, but the determination of what these restrictions should be is for the legislature to make after a thorough analysis of the economic and social factors involved. Any attempt by the courts to impose restrictions in piecemeal fashion without the aid of a complete analysis of the problem, which only the legislature is capable of undertaking, is bound to be unsatisfactory, as history well proves. The courts should end their recognition of any "public policy" against such a separation except one declared by statutes, and should restrict their activity to invalidating voting agreements for fraud or other specific illegal purpose. Classification of the right to vote as a property right which may exist independently would not only eliminate much of the confusion which exists today and make unnecessary much of the judicial dodging over the questions of "public policy" and "power coupled with an interest," but it would also place the burden of developing a comprehensive program for regulating voting agreements on the legislature, where it belongs.

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[31] In re Public Industrial Corp., 19 Del. Ch. 398, 168 A. 82 (1933); 2 C.J.S. (Agency) § 75.

[32] For a recent discussion of the revocability of proxies to vote stock, see 159 A.L.R. 307 (1945).