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## Chapter 6: Corporations and Partnerships

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## C H A P T E R 6

# Corporations and Partnerships

CHALMERS A. PEAIRS, JR.

**§6.1. Cumulative voting legislation.** A device frequently employed to insure at least a minimum representation to minority stockholders is the privilege of cumulative voting, under which a stockholder is permitted to cast all his votes for one, or a few, candidates, instead of being limited to one vote per share per candidate.

The effect of a cumulative voting privilege is perhaps best summarized by noting that it establishes a republican, as distinct from a democratic, form of corporate government. This form of government is guaranteed to stockholders by constitutional provision in a few states, and by statute in others. Where there is no express provision on the point, cumulative voting privileges are not automatic, but can normally be provided for in the corporate charter (that is, in the agreement of association and/or articles of organization, in Massachusetts); and this has long been true in this Commonwealth.<sup>1</sup>

In this permissive situation, there has never been much occasion for litigation in Massachusetts on cumulative voting; nor was there any here in 1955. A cause célèbre did arise, however, in another state, where the rule is mandatory.<sup>2</sup> This year the Massachusetts legislature enacted an express permissive statute, authorizing provision for cumulative voting in corporate articles or agreements of association.<sup>3</sup> This statute appears to add nothing to pre-existing law, but merely restates the practice which has existed here for many years.

In a number of nationally important corporations there were dur-

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§6.1. <sup>1</sup> See, generally, Stevens, *Corporations* §117 (2d ed. 1949); Ballantine, *Corporations* §117 (1946); Fletcher, *Cyclopedia of Corporations* §2048. The matter has not previously been expressly dealt with in Massachusetts law, though the permissive implications of the statutes were sufficiently clear to obviate the necessity of litigating the point. The possibility of such provisions is recognized, *semble*, in *Opinion of the Justices*, 261 Mass. 556, 159 N.E. 70 (1927).

<sup>2</sup> *Wolfson v. Avery*, 6 Ill.2d 78, 126 N.E.2d 701 (1955). A good comment on this case appeared in 9 *Miami L.Q.* 365 (1955).

<sup>3</sup> Acts of 1955, c. 173.

ing the year bitter fights over the election of directors.<sup>4</sup> These brought into prominence rules governing the solicitation and use of proxies, and the establishment and maintenance of a quorum, as well as the cumulative voting device. Of particular interest was the tactical problem arising under the latter.

The maximum number of directors which any block of stockholders can be sure to elect is determinable by the formula

$$D = \frac{V(B + 1)}{S} - 1$$

where D is the number of directors who can be elected, V is the number of votes available, B is the total number on the board to be elected, and S is the total number of shares of stock voting in the election.<sup>5</sup> However, if one faction tries to elect more or fewer than its maximum, an opposing faction may be able to improve on its chances under the formula.<sup>6</sup> If, for example, the majority tried to elect the entire board, its candidates would get sixty votes each, and the minority could thus elect a majority of the board, casting seventy-two votes for each of five candidates. On the other hand, if the minority tried to elect only two directors, the majority could elect the remaining seven, practically by default. The tactical question, then, is how large a representation on the board to try for, considering not only the formula but also what the opposing group(s) may try to do. The poker playing involved in this decision was a major factor in more than one large recent "proxy fight,"<sup>7</sup> and demonstrated that a

<sup>4</sup> See, among many other news accounts, the following:

*Business Week*: Trying to Run Railroads, Feb. 20, 1954, p. 28; Wild, Woolly Central Fight for N Y Central: New Faces and ICC, Too, Mar. 6, 1954, p. 26; It's an Old-Fashioned Free-for-All, Apr. 10, 1954, p. 52; Back to Roost, Apr. 10, 1954, p. 61; He's Taking Over the New Haven, Apr. 24, 1954, p. 33; Meeting Settles Down to a Long Count, June 5, 1954, p. 29; Fighting All Over the Lot, Feb. 26, 1955, p. 26; Ready for the Rollcall at Ward, Apr. 9, 1955, p. 27; Wolfson Gets a Foot in Montgomery Ward's Boardroom, Apr. 30, 1955, p. 28.

*Fortune*: Maurer, Central Rolls Again, May, 1954, p. 86; How Young Got the Votes, Aug. 1954, p. 87; What's Good for Montgomery Ward? Dec. 1954, p. 93; Wolfson, Reply, Feb. 1955, p. 23.

*New Yorker*: Brooks, Great Proxy Fight, July 3, 1954, p. 28; Our Plunging Correspondents, May 21, 1955, p. 100.

Concerning an English management fight, see Gower, Corporate Control: The Battle for the Berkeley, 68 Harv. L. Rev. 1176 (1955).

A possible correlation between the incidence of intracorporate management contests and the availability of cumulative voting is suggested by Williams, Cumulative Voting, 33 Harv. Bus. Rev. 108, 113 (1955).

<sup>5</sup> See, inter alia, Gerstenberg, Mathematics of Cumulative Voting, 9 J. Accountancy 177 (1910).

<sup>6</sup> See Cook, Corporations §609 a. (8th ed. 1923).

<sup>7</sup> See  $X = 1 + YN, /N + 1$  Plus Bluffing, *Business Week*, Apr. 23, 1955, p. 31; Handbook to Cumulative Voting, id. May 1, 1954, p. 68.

good bit more than simple electoral strength is involved in fixing the composition of a board of directors in a corporation whose stockholders are split into antagonistic factions.

**§6.2. Business development corporations: The Back Bay development.** The fact that the American nation, though substantially united politically, remains, perhaps inevitably, economically provincialized, has taken an increasingly prominent place in public attention during the past fifteen years. The Federal Government, to be sure, has not as yet developed an integrated, coherent policy on the interrelation of the various economic provinces; but the latter, conscious perhaps of the maxim about those who help themselves, have done much for their own well-being. The South and the Southwest have been the most aggressive regions, in this respect, on the mainland. They have been closely followed by the Pacific Northwest, but the South has been of greatest interest to New England observers, as it has appeared that much of the South's increase in relative wealth has been at the expense of New England.

Since about 1950 much has been done in the New England area designed to improve its economic situation. Public consciousness of the problem has been stimulated by vast publicity programs; political figures have done a great deal of talking, directed mostly toward recouping New England's relative position by trying to obtain discriminatory favors from the Federal Government; and every New England state has launched an organized program designed to improve its absolute economic situation. All these types of activity, moreover, have been carried on as well in behalf of separate localities, and particularly by the larger cities.<sup>1</sup>

The mechanism which has been used as the framework of most of this work is the development corporation. This device, a nonprofit, specially chartered corporation, like the Boy Scouts, the Red Cross, the Emergency Shipping Fleet Corporation, or the RFC, has been used by every New England state and by a number of smaller areas, and is also increasingly thought of as the means of carrying out new federal ventures in areas such as atomic energy exploitation or medical research. In many of these cases, of course, such a corporation carries out a purely governmental function, serving as a substitute for the administrative commission, and employed because of the greater operating efficiency and flexibility of the corporate structure, and to obtain some freedom from the defects common among such commissions. Frequently, however, the reason for this form is that the task to be done is proprietary rather than governmental — the traditional *raison d'être* of the governmental corporation — or, as here, that the

§6.2. <sup>1</sup> The creation in 1953 of the Massachusetts Department of Commerce, and the activities of the Department, including the incorporation of the Massachusetts Business Development Corporation, by Acts of 1953, c. 671, form the most significant local example of this kind of activity.

task is unrelated in nature to those traditionally performed by governmental agencies.<sup>2</sup>

The development corporation characteristically acts as stimulus, catalyst, middleman, promoter, publicity and public relations agent, and perhaps as underwriter, for new business in a given area. Private agencies may be doing parallel work, and are aided and encouraged by the public corporation when they are. There may also be the jobs of policing such development, by devising and applying regulations to keep its progress orderly, efficient, and inoffensive to potential critics or opponents; of allocating special benefits which the state may have provided on a limited basis; and of administering such benefits where they are available to all participants in the program. Principal among these latter is the tax concession—abatement, moratorium, special deduction, discriminatory assessment, and the like—and herein lay a constitutional question considered by the Supreme Judicial Court Justices during the 1955 SURVEY year.

An opportunity for an artificially stimulated development of this kind, with consequent long-range advantages to Boston, was seen in the discontinuance of use of the twenty-eight-acre railroad yard in the Back Bay area. A special commission, created at the Governor's suggestion in 1954,<sup>3</sup> recommended creation of a Back Bay Development Corporation, and in the legislation filed for this purpose included several proposals for tax concessions to this corporation, largely in the nature of fixed assessment ceilings and deferred collection procedures.<sup>4</sup> The constitutionality of this proposed act was the subject of a request by the Massachusetts Senate for an opinion of the Supreme Judicial Court; the Justices found that the tax concessions contained would be unconstitutional.<sup>5</sup> The discrimination in favor of one taxpayer, they pointed out, is necessarily also a discrimination against other taxpayers, denying them the proportionate sharing of government costs, the corollary proportional assessments, and the equal protection of

<sup>2</sup> The Massachusetts program has been to a large extent carried on through this device. See Woods, *A Report on the Massachusetts Business Development Corporation to Date*, published in the September, 1955, issue of *Industry*, the organ of the Associated Industries of Massachusetts, and separately available through the MBDC. See also a study for the Filene Foundation, *No. 1 Step in Commercial and Industrial Promotion (1950)*; and various publications of the Industrial Development Committee of the New England Council and of the Boston Federal Reserve Bank. Many issues of the latter's *Monthly Review* during about the past five years have dealt with the business development corporation, including development credit corporations (used in Maine), and with the related device of the industrial foundation. These reviews include specific descriptions of programs at the municipal level, including those at Danbury, Ware, Belfast, Laconia, and Worcester (the last-named operates more informally, through a local Committee for Economic Development).

<sup>3</sup> Resolves of 1954, c. 98. The Governor's message is House Doc. 2936 (1954).

<sup>4</sup> The Commission's report, with the text of the proposed act appended, is Senate Doc. 580 (1955).

<sup>5</sup> Opinion of the Justices, 1955 Mass. Adv. Sh. 541, 126 N.E.2d 795.

the laws, guaranteed by Article X of the Declaration of Rights and Article IV of the Massachusetts Constitution, and by Amendment XIV of the Federal Constitution.

The consequence of this opinion seems to be that in Massachusetts, at least, and very likely elsewhere as well, discriminatory tax benefits cannot be included in the inducements offered by business development programs; the decision appears to be of major consequence, if it is followed, as such benefits have played a large part in such development activities, across the country, up until this time. This case is further discussed in another chapter.<sup>6</sup>

**§6.3. The Dartmouth College law.** A separate point presented in the *Back Bay Development Corporation* opinion<sup>1</sup> responded to the question whether the powers, duties, and existence of the proposed corporation could constitutionally be guaranteed against impairment in any way which would affect adversely the rights of lenders, while any borrowings remained outstanding. The Justices found this proposal unconstitutional, it being in direct conflict with Article LIX of the Amendments to the Massachusetts Constitution, which requires that "Every charter, franchise or act of incorporation shall forever remain subject to revocation and amendment," and they expressly rejected the idea of regarding such a provision as a contract of the Commonwealth and thus exempt from the constitutional bar.

**§6.4. Fiduciary business relationships.** There are some business relationships, such as those of director and corporation, of principal and agent, or of members of a partnership, the essential ingredient of whose existence is a mutual general agency among the partners. In other cases, where the obligations of these relationships are violated, or where there has been fraud or trickery, a secondary fiduciary relationship may be imposed, through the medium of a constructive trust. Several Massachusetts cases during the 1955 SURVEY year decided questions, largely factual, as to the existence of one kind or another of fiduciary business relationship.

*Barry v. Covich*<sup>1</sup> and *Martin v. Stone*<sup>2</sup> arose from efforts to invoke the rule that when one acquires for himself property which he owes a fiduciary obligation to acquire for another, a constructive trust will be impressed on such property to get it into the hands of the one who should have had it. In each case the Court assumed the existence of the rule, and the Court's language points toward applying it broadly rather than narrowly; but in each case plaintiff failed in establishing factually the pre-existing fiduciary relationship — an agency in *Barry v. Covich*, a partnership in *Martin v. Stone* — on which the constructive trust claim was based.

<sup>6</sup> See §11.6 *infra*.

§6.3. <sup>1</sup> Opinion of the Justices, 1955 Mass. Adv. Sh. 541, 126 N.E.2d 795.

§6.4. <sup>1</sup> 332 Mass. 338, 124 N.E.2d 921 (1955).

<sup>2</sup> 1955 Mass. Adv. Sh. 471, 126 N.E.2d 196.

Plaintiffs' difficulty in *Barry v. Covich* was that there was no one who could qualify as principal of the alleged agency. Defendants' negotiations were with a committee of members of a social club; but the club itself did not, as an unincorporated association, have legal existence and thus could not be a principal, nor sue in court; the committee lacked by-law authority to bind all the members as a group of individuals; and no intent appeared either that the members negotiating should themselves alone be the principals, or that all members ("playing members" of the golf club) should be principals of an actual agency, as many of the latter lacked even knowledge of the transaction.

In *Martin v. Stone* plaintiff's contention was that he and defendant were partners; but all that appeared was that they had been, with another, principal stockholders of two corporations. The Court pointed out that this "did not make them partners or either corporation a partnership,"<sup>3</sup> and held the use of the term "partner" in the parties' conversations insufficient to show intent to form a partnership, lacking the essential elements of such an association.<sup>4</sup>

In *Keith Oil Corp. v. Keith*<sup>5</sup> one question related to the propriety of discharging a bookkeeper whose tenure was contractually guaranteed "except for failure properly to discharge [his duty]." It appeared that the bookkeeper had given information concerning the corporation to one hostile to the management, and this was held sufficient ground for discharge. The Court refers to the bookkeeper's job as a "position of confidence," and the decision seems to attach a certain fiduciary flavor to the position.<sup>6</sup>

**§6.5. Corporate accounting.** A second issue in the *Keith Oil Corp.*<sup>1</sup> case was the interpretation of a promissory note acceleration provision in case of "a loss for any full year of operation." A holding for obligors was based primarily on the proposition that such a clause should be construed to apply only to full years completed after obligors assumed management control.<sup>2</sup> The trial court also found that a calendar business year would be normal in this business, which is seasonal, and that in point of fact there was actually no loss during

<sup>3</sup> 1955 Mass. Adv. Sh. at 476, 126 N.E.2d at 200.

<sup>4</sup> It also seemed that plaintiff admitted himself out of court on the partnership claim by using the terms "joint venture" and "co-adventurer" in his appellate brief. The Court's express comment on this point, moreover, may contain an implied holding on the possibility of basing a constructive trust on breach of faith in a joint venture, as distinct from a partnership; but this is not clear, as breach of faith was not taken to be established by the evidence here.

<sup>5</sup> 1955 Mass. Adv. Sh. 479, 126 N.E.2d 185. This case is another chapter in a protracted intra-family quarrel which also gave rise to *Ashley v. Keith Oil Corp.*, 73 F. Supp. 37 (D. Mass. 1947).

<sup>6</sup> See also *Walsh v. Atlantic Research Associates*, 321 Mass. 57, 71 N.E.2d 580 (1947); *Oehme v. Whittemore-Wright Co.*, 279 Mass. 558, 181 N.E. 733 (1932).

§6.5. <sup>1</sup> 1955 Mass. Adv. Sh. 479, 126 N.E.2d 185.

<sup>2</sup> And see *Stein v. Strathmore Worsted Mills*, 221 Mass. 86, 108 N.E. 1029 (1915).

any year, whenever beginning and ending; and the appellate court in its holding did not dispute these findings.<sup>3</sup>

§6.6. **Corporate parties in actuality and in estoppel.** In two cases corporate defendants in contract actions argued that they had not been parties to the contracts sued on. In the first, *Wallach v. Hadley Co.*,<sup>1</sup> the question was largely whether the contracting agent could bind defendant to pay for plaintiff's services to all members of a multi-corporation business. Holding that he could, the Court relied on evidence of actual authority of the agent to deal with affairs of all the members of defendant's concern, and summarily rejected the suggestion that it would be ultra vires for defendant, apparently the parent or central corporation ("the main store"), to hire such services for other corporate members of the concern, distinguishing the accommodation indorsement cases.<sup>2</sup>

In *Wiley & Foss v. Saxony Theatres*<sup>3</sup> the facts taken for purposes of the appeal were that defendant's agent hired plaintiff to do work in its theater, and that later the same agent hired plaintiff to do similar work in another theater, owned by a different corporation, doing business at the same address, with largely the same offices as defendant, and now insolvent, and that no advance notice was given plaintiff that the later work was contracted for in behalf of a different corporation. The Court addressed itself in its opinion principally to matters of evidence. Apparently the legal point of defendant's liability on the contract, which was an express ground of defense, is assumed in plaintiff's favor on the ground of estoppel, but this is not express in the opinion, which seems regrettably laconic on the point.

<sup>3</sup> It is arguable whether the existence of these apparently independently sufficient grounds for the decision weakens the case, or whether the willingness of the Court to decide the legal point, rather than resting on the factual findings, indicates stronger than normal opinions on the law. It may, of course, hint some unexpressed reservations on the findings themselves, rather than any particular strength of conviction on the law. The record in the case supports the factual findings, indicating that the alleged loss for the earlier fiscal year rested on bookkeeping error. Record, pp. 61-71, especially at 69.

§6.6. <sup>1</sup> 331 Mass. 699, 122 N.E.2d 355 (1954).

<sup>2</sup> *Commercial Casualty Ins. Co. v. Daniel Russell Boiler Works*, 258 Mass. 453, 155 N.E. 422 (1927); *Bennett v. Corporation Finance Co.*, 258 Mass. 306, 154 N.E. 835 (1927).

<sup>3</sup> 332 Mass. 172, 124 N.E.2d 903 (1955).