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Chapter 6: Corporations

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CHAPTER 6

Corporations

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§6.1. Cumulative voting legislation. In what appears to be a surprising reversal of policy the 1956 session of the Massachusetts legislature[1] repealed a 1955 statute[2] which for the first time had granted express statutory permission for the use of cumulative voting in business corporations. Cumulative voting has been accurately described as a "device frequently employed to insure at least a minimum representation to minority stockholders" [3] on the board of directors.[4]

The 1956 statute by restoring G.L., c. 156, §32 to its pre-1955 form has apparently invalidated cumulative voting in Massachusetts, a view which is supported not only by the language of the statute[5] but both by administrative practice[6] and by the action taken by the legislature on this subject during the 1955 and 1956 sessions. Corporations which adopted this device pursuant to the 1955 act presumably must henceforth [7] elect their directors under a noncumulative voting procedure, since a corporation organized under the General Laws is always subject to laws subsequently passed.[8]

The most interesting aspect of this problem, of course, is the question as to why the legislature favored cumulative voting in 1955 and opposed it in 1956. In the absence of committee reports some, at

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§6.1. [1] Acts of 1956, c. 375.

[2] Acts of 1955, c. 173.

[3] 1955 Ann. Surv. Mass. Law §6.1.

[4] The 1955 statute established the normal cumulative voting procedure under which each voting stockholder at the election of directors was entitled to a number of votes equal to the number of his shares of stock multiplied by the number of directors to be chosen with the right to cast all his votes for one director or to divide his votes as he saw fit. For a discussion of the mathematics involved in using this device, see 1955 Ann. Surv. Mass. Law §6.1.

[5] "Stockholders entitled to vote shall . . . have one vote for each share of stock owned by them . . ." G.L., c. 156, §32.

[6] Officials at the Department of Corporations have indicated that prior to the passage of the 1955 statute provisions for cumulative voting in corporate organization papers would have been rejected as invalid.

[7] The 1956 act was passed on May 18, 1956, and became effective ninety days later. Directors elected by cumulative voting pursuant to a provision in the agreement of association adopted while the 1955 act was in force were, of course, validly chosen and may serve out their terms.

[8] G.L., c. 155, §3.

least, of the possible answers to this question have been obtained through interviews by members of the Board of Student Editors of the ANNUAL SURVEY with various persons who were interested in the passage of the two acts. The proponents of the 1955 statute advanced the familiar argument that cumulative voting by permitting minority representation on the board of directors was a desirable practice, and that in view of the growing interest in this procedure in other jurisdictions Massachusetts should keep pace in order to maintain its competitive position.

Although there appears to have been no flood of new corporations with cumulative voting provisions, or of amendments by existing corporations to take advantage of the new act, the Associated Industries of Massachusetts urged the repeal of the 1955 statute, asserting that the adoption of cumulative voting led or would lead to proxy fights by groups seeking to obtain representation on the boards of corporations, and that fear of this development might discourage new industries from incorporating in Massachusetts.

Whether the hopes of those favoring cumulative voting or the fears of those opposing it have more substance is difficult to determine. In any event no opposition to the 1956 proposal appeared, so that cumulative voting after a brief existence of slightly over one year has disappeared from the Massachusetts scene.[9]

§6.2. **Breaking the corporate deadlock.** *Zottu v. Electronic Heating Corp.*,[1] although not noteworthy of itself, involved resort to an infrequently used statute[2] when the stockholders found themselves deadlocked on a question affecting the management of the corporation. The plaintiff, holder of 50 percent of the stock, invoked the statute and sought the appointment of a receiver. The Supreme Judicial Court ultimately decided that there was no way of breaking the deadlock and exercised its discretionary power under the statute to order sale of all the assets and the dissolution of the corporation.

The *Zottu* case serves as a reminder of one of the less commonly considered risks involved in using the corporate form. Persons associated together in business can so readily incorporate their venture that they often overlook the difficult problems which must be solved when basic disagreements occur. Although a partner can always compel the dissolution of a partnership,[3] even before the expiration of its term,[4] a dissatisfied stockholder can force a dissolution only in accordance with the terms of the applicable statute.[5]

The Massachusetts act [6] requires that the petition for dissolution be filed by the holders of not less than 40 percent of the outstanding voting

[9] Section 32 of the draft of a new business corporation statute, prepared by a committee of the Boston Bar Association and now under study, would restore cumulative voting on a permissive basis. The draft is discussed in §6.5 *infra*.

§6.2. [1] 1956 Mass. Adv. Sh. 959, 135 N.E.2d 920.
[2] G.L., c. 155, §50.
[3] G.L., c. 108A, §31(1)(b).
[4] Id., §31(2).
[5] G.L., c. 155, §50.
[6] Ibid.

stock. Two basic types of deadlock may serve as the basis for a petition: (1) an equal division of the votes of the board of directors and the stockholders on a question affecting the general management of the affairs of the corporation, or (2) an equal division of the votes of the stockholders in the election of directors. The court, if it finds that there appears to be no way of reaching an agreement and breaking the deadlock, *may* decree a dissolution.

Although reported decisions under the statute are sparse, it is clear that the court may order a dissolution of even a prosperous corporation,[7] despite some suggestion to the contrary in a case decided under an earlier version of the statute.[8] A somewhat similar New York statute,[9] however, has been strictly construed by the courts of that state, particularly in the case of solvent corporations;[10] and dissolution has been denied upon a failure to show that the relief sought would be beneficial to the stockholders and noninjurious to the public.[11] The New York decisions may be warranted by the different language of the New York statute, but as a general proposition the courts should recognize that in the case of the closely held corporation at least, a deadlock among the stockholders is like a deadlock among partners.[12] And since a dissatisfied partner can always compel dissolution,[13] the court should not hesitate to dissolve the hopelessly deadlocked corporation.[14]

§6.3. **Corporate loans to stockholders: Director's liability.** Another corporate statute which is not frequently invoked was at issue in *National Refractories Co. v. Bay State Builders Supply Co.*[1] The statute in question[2] subjects a director to personal liability for assenting to a loan by the corporation to a stockholder or director; liability is limited to the amount of the loan and to debts contracted between the time the loan is made and its repayment. In the *National Refractories* case the defendant had resigned as director prior to the actual making of the loan to the stockholder, but upon a showing that the defendant

7 Zottu v. Electronic Heating Corp., 1956 Mass. Adv. Sh. 959, 961, 135 N.E.2d 920, 923.

8 Cook v. Cook, 270 Mass. 534, 542, 170 N.E. 455, 457 (1930).

9 N.Y. Gen. Corp. Law, art. 9, §103.

10 Radom v. Nerdoff, 307 N.Y. 1, 119 N.E.2d 563 (1954); Matter of Homer Fabrics, Inc., 137 N.Y.S.2d 701 (1955).

11 Matter of Norton and Schneider, 137 N.Y.S.2d 269 (1954).

12 Cf. Casey v. Harrington, 136 N.Y.L.J., No. 101, p. 13 (Sup. Ct. 1956), in which the court permitted dissolution of a deadlocked prosperous corporation on the ground that the two shareholders by disregarding corporate formalities had in fact become partners.

13 G.L., c. 108A, §31.

14 Section 91 of the draft of the new business corporation statute now under study by the Boston Bar Association committee would require a showing of actual or threatened irreparable injury to the corporation before the court could order liquidation of the deadlocked corporation, although such proof would not be necessary where there was a deadlock in the election of directors. The petition could be brought by any stockholder, irrespective of the amount of his holdings.

§6.3. 1 1956 Mass. Adv. Sh. 1069, 137 N.E.2d 221.

2 G.L., c. 156, §37.

had actively participated in the transaction while still a director and that the loan proceeds were used by the borrower to repay a personal debt to the defendant, the Court very properly imposed liability.

Since corporate loans to stockholders and directors are a common practice in the closely held enterprise, directors who approve such a loan should be aware of the risks involved if insolvency were to ensue before the loan was repaid. Perhaps the most dangerous situation is where the director has severed his connection with the corporation while the loan is still outstanding. Since the liability continues even as to future creditors, the departing director would be well advised to seek some kind of indemnity. The statute of limitations affords him little protection, since the cause of action does not arise until the creditor (perhaps many years later) makes written demand for payment on the corporation and payment is not made within ten days thereafter.[3]

§6.4. **Nonprofit corporations: Annual reports.** Prior to 1955 certain types of nonprofit corporations were required to file annual reports with the State Secretary by November 1, setting forth the address, date of annual meeting, and the names and addresses of the officers and directors of the organization.[1] In 1955 the legislature broadened the scope of corporations obligated to make such returns to include substantially all nonprofit corporations organized under Chapter 180 of the General Laws except for churches and medical schools.[2]

Although the return requirement was not onerous, it obviously did not make much sense to exempt churches and schools of medicine and yet include the nonprofit schools, colleges, and hospitals. Accordingly, the statute was further amended in 1956 [3] so that under the present law virtually all charitable corporations, as well as social, fraternal, and trade groups, must file returns with the exception of churches, religious organizations, nonprofit schools, colleges, or hospitals, and certain political organizations.

§6.5. **Model business corporation act.** One of the most significant developments in Massachusetts corporate law during the 1956 SURVEY year was the completion of the draft of a revised business corporation statute for Massachusetts by a committee working under the auspices of the Boston Bar Association. The new statute is largely modeled after the Model Business Corporation Act prepared by the Committee on Corporate Laws of the American Bar Association. Several states have in recent years adopted modified versions of the Model Act, and the Bar Association committee has attempted to synthesize its provisions with those of the present Massachusetts statute. Copies of the draft have been circulated among members of the bar for study and comment.

[3] G.L., c. 156, §38.

§6.4. [1] G.L., c. 180, §26A.
[2] Acts of 1955, c. 290.
[3] Acts of 1956, c. 390.