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Corporations - Officers and Directors - Agreement Interfering with Management by Board of Directors

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CORPORATIONS—OFFICERS AND DIRECTORS—AGREEMENT INTERFERING WITH MANAGEMENT BY BOARD OF DIRECTORS—Plaintiffs, minority stockholders in a closely held corporation, asked that the court declare invalid an agreement between the majority stockholders and their “agent-directors” for the management of the business. The agreement provided that for ten years the stock of the parties to the agreement would be voted as a unit as any seven of the agents should direct or, if they could not agree, as directed by an arbitrator chosen by them. The agents were to be elected to the board of directors by the stockholders who appointed them. Under a cumulative voting provision, the parties to the agreement had sufficient shares to elect eight directors. It was further agreed to maintain the number of directors at fifteen, to remove any director who voted contrary to any plan which they favored, and to confer on all matters of policy and planning for future action. If any seven of the agent-directors failed to agree, the matter was to be submitted to an arbitrator. The plaintiffs attacked the agreement on the ground that it deprived the directors of their discretion and made management by the board a mere sham. The defendants argued that the provisions of the agreement merely tended to preserve control in the hands of the majority and were absolutely necessary in today’s business world. *Held*, the agreement is an invalid attempt to encroach upon the directors’ exercise of independent business judgment and might possibly permit director action to be dictated by an outsider or a minority of the board, thus violating the Delaware Corporation Law. *Abercrombie v. Davies*, (Del. 1956) 123 A. (2d) 893.

The corporate director is not simply the agent of the stockholders who elect him.¹ His function is defined by the legislature of the state of incorporation.² He is required to exercise his best judgment for the benefit of all the stockholders.³ It would follow logically that any agreement

¹ *Manson v. Curtis*, 223 N.Y. 313, 119 N.E. 559 (1918); *Hoyt v. Thompson’s Executor*, 119 N.Y. 207 (1859).

² *New York Dock Co. v. McCollom*, 173 Misc. 106, 16 N.Y.S. (2d) 844 (1939).

³ *Billings v. Shaw*, 209 N.Y. 265, 103 N.E. 142 (1913).

which limits the business discretion of the director would be void as contrary to the legislative mandates which direct that "the business of every corporation shall be managed by a board of directors."⁴ It is impossible to dispute the fact that a legislature has the power to define the function of the corporate director, but the language used in most statutes is of little help in deciding cases.⁵ The majority of courts read their statutes as prohibiting agreements which curb the discretion of the board of directors or re-delegate the power of management,⁶ though there have been many exceptions to the strict construction.⁷ Under the terms of the agreement in the principal case, the agents were bound to cast their votes as directors in a unit. Thus, the power of management was taken from the entire board and could be exercised either by a minority (seven of the eight directors who were parties to the agreement) or by an outsider (an arbitrator appointed by them). The avowed purpose of this agreement was clear, viz., to initiate and maintain policies which the parties determined were to their joint benefit. The chancellor was equally clear that it was invalid because it violated the mandate of the statute. The agreement was designed to achieve a degree of control generally associated with a partnership, not a corporation. Legal writers have argued that the board of directors manages the business of a corporation not because of any legislative or public policy, but because of the "business necessity" for centralized control.⁸ From this premise they conclude that in the case of

⁴ Forty states have provisions in their corporation statutes which require management by a board of directors. Ark. Stat. (1947) §64-401; Cal. Corp. Code Ann. (Deering, 1953) §800; Conn. Gen. Stat. (1949) §5165; Del. Code Ann. (1953) tit. 8, §141; Fla. Stat. (1955) §608.09; Ga. Code Ann. (Supp. 1955) §22-1864; Idaho Code (1948) §30-139; Ill. Rev. Stat. (1955) c. 32, §157.33; Ind. Stat. Ann. (Burns, 1942) §25-208; Kan. Gen. Stat. Ann. (Corrick, 1949) §17-3101; Ky. Rev. Stat. (1953) §271.345; La. Rev. Stat. (1950) tit. 12, §34; Md. Code Ann. (Flack, 1951) art. 23, §48; Mass. Laws Ann. (1948) c. 156, §21; Mich. Comp. Laws (1948) §450.13; Minn. Stat. (1953) §301.28; Mo. Stat. Ann. (Vernon, 1952) §351.310; Mont. Rev. Code Ann. (1947) §15-401; Neb. Rev. Stat. (1954) §21-111; Nev. Comp. Laws (Hillyer, 1929) §1630; N.H. Rev. Stat. Ann. (1955) §294:89; N.J. Stat. Ann. (1939) tit. 14, §7-1; N.M. Stat. Ann. (1953) §51-2-14; 22 N.Y. Consol. Laws (McKinney, 1943) §27; N.C. Gen. Stat. (1950) §55-48; N.D. Rev. Code (1943) §10-0507; Ohio Rev. Code (Baldwin, 1953) §1701.63; Okla. Stat. (1951) tit. 18, §1.34; Ore. Rev. Stat. (1953) §57.180; Pa. Stat. Ann. (Purdon, Supp. 1955) tit. 15, §43; R.I. Gen. Laws (1938) c. 116, §20; S.D. Code (1939) §11.0705; Tenn. Code Ann. (Williams, 1934) §3742; Tex. Civ. Stat. (Vernon, 1945) art. 1327; Utah Code Ann. (1953) §16-2-21; Vt. Stat. (1947) §5779; Va. Code (1950) §13-201; Wash. Rev. Code §23.36.010; W.Va. Code (1955) §3028; Wis. Stat. (1955) §180.30.

⁵ Hornstein, "Judicial Tolerance of the Incorporated Partnership," 18 LAW AND CONTEMP. PROB. 435 (1953).

⁶ *Manson v. Curtis*, note 1 supra; *Hoyt v. Thompson's Executor*, note 1 supra; *Jackson v. Hooper*, 76 N.J. Eq. 592, 75 A. 568 (1910); *Templeman v. Grant*, 75 Colo. 519, 227 P. 555 (1924); *McQuade v. Stoneham*, 263 N.Y. 323, 189 N.E. 234 (1934); *West v. Camden*, 135 U.S. 507, 10 S.Ct. 838 (1889); *Benintendi v. Kenton Hotel, Inc.*, 294 N.Y. 112, 60 N.E. (2d) 829 (1945); *Long Park, Inc. v. Trenton-New Brunswick Theatres*, 297 N.Y. 174, 77 N.E. (2d) 633 (1948).

⁷ In *Clark v. Dodge*, 269 N.Y. 410, 199 N.E. 641 (1936), an agreement between directors who were also the sole stockholders to vote in the future for certain officers was specifically enforced.

⁸ 23 N.Y.L.Q. REV. 150 (1948); Delaney, "The Corporate Director: Can His Hands Be Tied in Advance?" 50 COL. L. REV. 52 (1950); Hornstein, "Stockholders' Agreements in the

the closely held corporation where there is no such necessity courts should uphold agreements by a majority of the stockholders which dilute the directors' power to manage if the non-participating minority is not thereby damaged or defrauded.⁹ This approach is supposedly realistic and avoids strict adherence to "statutory norms" or technical rules.¹⁰ It also avoids the statute.¹¹ It is difficult to understand why the typical statutory language, "the business of every corporation shall be managed by a board of directors," should be read, "the business of every corporation shall be managed by a board of directors unless the stockholders provide otherwise." It is not contended that the typical language is so clear that it needs no interpretation or that it should permit of no exceptions, but to validate the usurpation of director power in the principal case it would be necessary to assume that legislators neither mean what they say nor say what they mean. If there is a need for special laws for closely held corporations which would confer upon them the advantages of incorporation yet permit them to be managed like partnerships, this is an area for legislation of the non-judicial variety. The chancellor is surely right in paying heed to the statutory scheme when dealing with a creature created by that statute. There should be some stronger reason than "business necessity" for ignoring a statutory provision.

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Closely Held Corporation," 59 YALE L.J. 1040 (1950); STEVENS, PRIVATE CORPORATIONS, 2d ed., §143 (1949).

⁹ This idea apparently originated in the dictum of *Manson v. Curtis*, note 1 *supra*, but it was there coupled with the requirement that the agreement not substantially deviate from the corporate norm.

¹⁰ Delaney, "The Corporate Director: Can His Hands Be Tied in Advance?" 50 COL. L. REV. 52 at 65 (1950).

¹¹ It is idle to say that agreements which fetter a director's discretion do not violate any "public policy." If public policy is anything more than a figment of the imagination, what better place to look for it than in the statutes themselves? The difficult problems of statutory interpretation are not solved by vague references to vague "policies."