Corportations - Cumulative Voting, Classified Boards and Proportional Representation

William R. Luney S.Ed.

University of Michigan Law School

Follow this and additional works at: https://repository.law.umich.edu/mlr

Part of the Business Organizations Law Commons, and the Securities Law Commons

Recommended Citation


Available at: https://repository.law.umich.edu/mlr/vol55/iss7/5

This Response or Comment is brought to you for free and open access by the Michigan Law Review at University of Michigan Law School Scholarship Repository. It has been accepted for inclusion in Michigan Law Review by an authorized editor of University of Michigan Law School Scholarship Repository. For more information, please contact mlaw.repository@umich.edu.
CORPORATIONS — CUMULATIVE VOTING, CLASSIFIED BOARDS AND PROPORTIONAL REPRESENTATION — In two recent decisions, Wolfson v. Avery¹ and Janney v. Philadelphia Transportation Co.,² a constitutional provision³ guaranteeing to every corporate shareholder the right to cumulate⁴ his votes in an election of directors was construed in light of a statute⁵ authorizing the classification


³ Ill. Const., art. II, §3: "... [I]n all elections for directors or managers of incorporated companies, every stockholder shall have the right to vote... for the number of shares of stock owned by him, for as many persons as there are directors or managers to be elected, or to cumulate said shares, and give one candidate as many votes as the number of directors multiplied by the number of his shares of stock shall equal, or to distribute them on the same principle among as many candidates as he shall think fit..."). Pa. Const., art. 16, §4: "In all elections for directors or managers of a corporation each member or shareholder may cast the whole number of his votes for one candidate, or distribute them upon two or more candidates, as he may prefer."

⁴ Cumulative voting entitles a shareholder to votes equal to the number of his shares multiplied by the number of directors to be elected. The percentage of voting shares needed to elect X directors = (the percentage of outstanding shares voting, multiplied by X) + (the number of directors being elected, plus one). Williams, Cumulative Voting for Directors 41 (1951). See also Leckemby, "Classification of Directors and Its Effect Upon Cumulative Voting in Corporate Elections," 56 Dick. L. Rev. 330 (1952).

⁵ Ill. Rev. Stat. (1955) c. 32, §157.35: "When the board of directors shall consist of nine or more members, in lieu of electing the whole number of directors annually, the by-laws may provide that the directors be divided into either two or three classes, each
of directors and the election of only one class annually. In both, it was argued by a minority shareholder that the constitutional provision guaranteed him representation on the board proportional to his stock holdings, and that the classification statute, authorizing a reduction of the number of directors to be elected at each election, required a greater number of share votes to elect a single director and thereby impaired his constitutional right to proportional representation on the board. The *Wolfson* case accepted the shareholder's argument; the *Janney* case rejected it.

The decisions indicate a fundamental difference in interpretation of the constitutional provision for cumulative voting: Was such a provision intended to assure the minority proportional representation on the board, or only to enable a sufficient minority to secure some representation? If the former, then a classification statute would be beyond the power of the legislature, since it would defeat proportional representation by requiring a greater number of share votes to elect a single director. If the latter, the classification statute would be valid, since it would not negate the minority's right to cumulate, but only limit the effective exercise of that right. The intent of the constitutional framers can best be discovered by a consideration of the language of the constitu-

---


9 In the *Wolfson* case, where a nine-director board was classified into three classes, it was undisputed that it would require 250% as many votes to elect a director in a three-director election as would be necessary if all nine directors were to be elected at the same time. In the *Janney* case, where sixteen elected directors were classified into two classes, the percentage was approximately 190%. See note 4 supra.

tional provisions themselves in context, or, should the language be ambiguous, by indications of intent given by extrinsic evidence. Consideration will initially be given to the incidence of cumulative voting and classification in the United States.

I. Incidence of Cumulative Voting and Classification

Cumulative voting for corporate directors, a device unknown to the common law,\(^\text{11}\) is a comparatively recent constitutional and legislative innovation.\(^\text{12}\) It had its origin in the excesses of corporate management in the latter half of the nineteenth century,\(^\text{13}\) and was designed to enable minority shareholders to gain representation on the board of directors.\(^\text{14}\) Provisions for cumulative voting took one of two forms. The mandatory provision guaranteed the right of cumulative voting to the shareholder regardless of any provision to the contrary in the corporate charter or by-laws.\(^\text{15}\) Such a right is provided in the constitutions of thirteen

\(^\text{11}\) At common law, the majority, under straight voting, elected every member of the board. In re Brophy, 13 N.J. Misc. 469, 179 A. 128 (1934); Commonwealth ex rel. O'Shea v. Flannery, 203 Pa. 28, 52 A. 129 (1902); State v. Perham, 50 Wash. (2d) 384, affd. 229 N.Y. 516, 129 N.E. 897 (1920).

\(^\text{12}\) The idea of cumulative voting for corporate directors was first articulated in the Illinois Constitutional Convention of 1870. Williams, Cumulative Voting for Directors, 20 COLUMBUS BULL. 34 (1951).

\(^\text{13}\) Receiving widespread publicity during this period were the operations of Messrs. Drew, Fisk and Gould in the Erie Railroad. See generally Campbell, "The Origin and Growth of Cumulative Voting for Directors," 10 BUSINESS LAWYER, No. 3, p. 3 (1955); Williams, Cumulative Voting for Directors 20, 34 (1951).

\(^\text{14}\) "The remainder of the stockholders are in the dark. They have nobody in the board to watch their interests, to protect against waste, extravagance or mismanagement, or to take any steps to protect them until it is too late." Joseph Medill, 2 DEBATES OF THE CONSTITUTIONAL CONVENTION OF THE STATE OF ILLINOIS 1666 (1870). Sold and Fuge, "Impact of Classified Corporate Directorates on the Constitutional Right of Cumulative Voting," 17 UNIV. PITT. L. REV. 151 (1956); 43 A.L.R. (2d) 1322 (1955). It is possible that a cumulatively voting minority may elect a majority of the board of directors when the majority does not cumulate its votes or cumulates them improperly. Pierce v. Commonwealth, 104 Pa. 150 (1883); Swartz v. State, 61 Ohio St. 497, 56 N.E. 201 (1900); Chicago Macaroni Co. v. Boggiano, 202 Ill. 312, 67 N.E. 17 (1903); State ex rel. Springs v. Ellison, 106 S.C. 139, 90 S.E. 699 (1916). See generally Cole, "Legal and Mathematical Aspects of Cumulative Voting," 2 S.C. L.Q. 225 (1950); Bowes and De Bow, "Cumulative Voting at Elections of Directors of Corporations," 21 MINN. L. REV. 351 (1937). However, legislation requiring notice of intention to cumulate would make a minority controlled board unlikely. See, e.g., Ohio Rev. Code (Baldwin, Supp. 1956) §1701.55.

\(^\text{15}\) Wright v. Central Calif. Colony Water Co., 67 Cal. 532, 8 P. 70 (1885) (resolution authorizing the election of only one director at each election held unconstitutional); Tomlin v. Farmers and Merchants Bank, 52 Mo. App. 430 (1893) (resolution providing for election of directors by majority of shares held unconstitutional); People v. Deneen, 247 Ill. 289, 93 N.E. 437 (1910) (statute authorizing political party to reduce number of candidates to be nominated held unconstitutional in view of elector's right to cumulate his votes). But see People ex rel. Lindstrand v. Emmerson, 333 Ill. 606, 165 N.E. 217 (1929).
states, and in the statutes of seven. The permissive provision required that the corporation provide for cumulative voting in the charter or by-laws before the shareholder could cumulate his votes. Such a provision is included in the statutes of eighteen states, but no state has a permissive provision in its constitution. Ten states make no provision for cumulative voting.

Classification of the board of directors had its origin in the states’ attempts to attract prospective incorporators by providing for continuity of management in corporate boards. The statutes of


18 It is unlikely that such a provision would find its way into a corporate charter at the time of incorporation, since it would lessen the promoters’ control over the corporate enterprise. Steadman and Gibson, “Should Cumulative Voting for Directors Be Mandatory?—A Debate,” 11 Business Lawyer, No. 1, p. 9 (1955). Moreover, if cumulative voting is only permitted by statute, the privilege can be taken away by an authority equal to that which granted it. A majority of the shareholders can amend the charter to eliminate cumulative voting over the objection of the minority. Maddock v. Vordone Corp., 17 Del. Ch. 39, 147 A. 255 (1929); Quilliam v. Hebbronville Utilities, (Tex. Civ. App. 1951) 241 S.W. (2d) 225. Cf. Loewenthal v. Rubber Reclaiming Co., 52 N.J. Eq. 440, 28 A. 454 (1894) (where the by-law providing for cumulative voting was held part of the contract between the original incorporators and therefore not subject to amendment except as provided in the by-law). The state can repeal the cumulative voting statute under a reserved power to alter, amend or revoke over the objection of the corporation. Curran, “Minority Stockholders and the Amendment of Corporate Charters,” 32 Mich. L. Rev. 743 (1954).


20 Alabama, Connecticut, Florida, Georgia, Iowa, Maine, Massachusetts, New Hampshire, Utah, Wisconsin. In the absence of a cumulative voting provision in the constitution or statutes of the state of incorporation, it is to be doubted whether a shareholder would have the right to cumulate his votes in an election of directors. Ballentine, Corporations §177, p. 406 (1946). But see Campbell, “The Origin and Growth of Cumulative Voting for Directors,” 10 Business Lawyer, No. 3, p. 10 (1955) where it is argued that the corporation may provide for cumulative voting under the broad statutory power to regulate its internal affairs or define the voting rights of shareholders.

21 It is doubtful whether classification statutes were enacted primarily to limit cumulative voting, since many states which have not insisted on cumulative voting have authorized classification. Williams, Cumulative Voting for Directors 49 (1951). See also Shafer, “The Conflict of Cumulative Voting and Staggered Directorships,” 24 Univ. Cin. L. Rev. 560 (1955).

thirty-seven states make provision for classification. Included in this number are five of the seven states which guarantee cumulative voting by statute, and eight of the thirteen states which guarantee the right by constitutional provision. It is with this latter group of states, guaranteeing cumulative voting by constitution and providing for classification by statute, that this comment will be concerned.

II. Constitutional Language

None of the eight state constitutions which guarantee cumulative voting (and which provide for classification by statute) provide expressly that a shareholder shall be entitled to proportional representation on the board, so the right must arise by implication if


24 Arkansas, Kansas, Michigan, Ohio and Washington.

25 Illinois (prior to the Wolfson decision), Kentucky, Missouri, Montana, Nebraska, North Dakota, Pennsylvania and West Virginia.

26 Where both classification and mandatory cumulative voting are provided for by statute (note 24 supra), the judicial inquiry will be on narrower grounds of statutory construction, and if both statutes are susceptible of a reasonable construction which will nullify neither, both devices will be upheld. See, e.g., Humphrys v. Winous Co., 165 Ohio St. 45, 133 N.E. (2d) 780 (1956), noted in 55 Mich. L. REV. 139 (1956), 51 St. Johns L. REV. 126 (1956). See also 8 Ala. L. REV. 368 (1956); Stephan, "Cumulative Voting and Classified Boards: Some Reflections on Wolfson v. Avery," 31 NOTRE DAME LAWYER 351 at 372 (1956) ("In those states in which cumulative voting is made mandatory or permissive by statute and classified boards are permissive the [Wolfson] decision should have no judicial repercussions at all. In such states the legislatures have seen fit to give shareholders a right that is conditioned at its birth by the classification device.").

27 Among the states where both mandatory cumulative voting and classification are provided for by statute (note 24 supra), only the Washington statute refers expressly to
at all. The Illinois court in Wolfson found such an implied right; the Pennsylvania court in Janney did not. It is possible to distinguish the cases on the basis of the different constitutional language involved in each. The Illinois Constitution, in providing that the shareholder's votes should be cast for "directors or managers to be elected" and for the "number of directors," required that all directors be elected at each election, while the Pennsylvania Constitution, in referring to "candidates" instead of "directors," contemplated that less than all the directors might be standing for election at one time. The court in Janney drew this distinction to avoid the Wolfson holding. Even in Wolfson, it was argued by defendant corporation that the phrase "directors or managers to be elected" contemplated that less than all the directors might be standing for election at one time, and that therefore the constitutional framers could not have intended strictly proportional representation on the board. The Illinois court, in rejecting this argument, concluded that the phrase "to be elected" referred only to the possibility that the size of the board might be changed between elections. It is submitted that the ambiguous nature of proportional representation: “Proportional method of representation. In the election of directors, every shareholder of record shall have the right to multiply the number of votes to which he may be entitled . . . by the number of directors to be elected, and he may cast all such votes for one candidate or he may distribute them among any two or more candidates.” Wash. Rev. Code §25.32.070.

Necessary inference or implication can rule an act unconstitutional even though no express constitutional prohibition exists. See generally Sell and Fuge, “Impact of Classified Corporate Directorates on the Constitutional Right of Cumulative Voting,” 17 Univ. Pitt. L. Rev. 151 at 165 (1956).

The constitutions of Kentucky, Missouri, Montana, Nebraska and West Virginia provide for cumulative voting in substantially the same language as the Illinois Constitution, note 3 supra.

The North Dakota Constitution provides for cumulative voting in the same language as the Pennsylvania Constitution, note 3 supra.

"Whether [the Wolfson decision] be right or wrong, it distinguishes the case from the present one because the language in our own Constitution is different in that it makes no such reference to "directors" as determining the number of cumulative votes to which each stockholder is entitled." 387 Pa. 282 at 290.

Prior to the Wolfson decision, there were only two cases which discussed the effect of classification on cumulative voting. Pittsburgh Steel Co. v. Walker, 92 Pitt. L. J. 464 (Court of Common Pleas, Allegheny County, 1944); Cohen v. Byers Co., (Court of Common Pleas, Allegheny County, 1950) affd. per curiam 368 Pa. 618, 70 A. (2d) 837 (1950) (affirmed on other than constitutional grounds).

The court was aided in its interpretation by another section of the Illinois Constitution which provided in identical language for cumulative voting in elections of General Assembly representatives, and stated further that three representatives would be elected every two years. The court reasoned that since the number of directors and the frequency of their election was specifically stated, the phrase "to be elected" could not refer to those facts without being surplusage. See generally Cooley, Constitutional Limitations, 8th ed., 128-129 (1927).
both constitutional provisions justifies resort to extrinsic evidence to determine whether the constitutional framers intended that a shareholder would have the right to proportional representation on the board.\textsuperscript{34}

III. *Extrinsic Evidence of Intent*

The most significant extrinsic evidence of intent is the fact that classification of corporate directors had been authorized by state legislatures and practiced by corporations before cumulative voting was provided for by constitution.\textsuperscript{35} It is arguable that had the constitutional framers intended to alter an existing business practice by requiring strictly proportional representation, they would have done so expressly.\textsuperscript{36} But the constitutional debates on cumulative voting contain no reference to classification and little language that can be construed as requiring strictly proportional representation.\textsuperscript{37} Rather, the debates indicate that the evil intended to be remedied by cumulative voting was non-representation, not disproportionate representation.\textsuperscript{38} Also significant is the fact that, in both Illinois and Pennsylvania, legislatures subsequent to the constitutional convention enacted business corporation laws that provided for classification, and such enactments are evidence that

\textsuperscript{34} Resort to extrinsic evidence should be made only to resolve patent ambiguities in constitutional or statutory language, Cooley, *Constitutional Limitations*, 8th ed., 92 (1927). However, the Pennsylvania court in Janney found the constitutional language "clear and unambiguous" but also considered extrinsic evidence of intent. 387 Pa. 282 at 288.

\textsuperscript{35} Classification of directors had been practiced in Pennsylvania prior to the adoption of the cumulative voting provision. See generally Sell and Fuge, "Impact of Classified Corporate Directorates on the Constitutional Right of Cumulative Voting," 17 Univ. Pitt. L. Rev. 151 at 161 (1956). In Illinois, prior to the adoption of cumulative voting in the Constitution of 1870, at least 124 corporations organized by special act of the Illinois General Assembly had classified boards. Wolfson v. Avery, Brief for Appellants (Supreme Court) appendix A.

\textsuperscript{36} "There is no inconsistency between cumulative voting and classification, unless cumulative voting means proportional representation. If it should mean that, it is for the legislatures to say so in more specific language than they have heretofore used." Adkins, "Corporate Democracy and Classified Directors," 11 Business Lawyer, No. 1, p. 38 (1955).

\textsuperscript{37} For an extensive analysis of the constitutional debates on cumulative voting in Illinois, Pennsylvania and other states, see Williams, *Cumulative Voting for Directors* 20 (1951).

\textsuperscript{38} See, e.g., 2 Debates of the Constitutional Convention of the State of Illinois 1666 (1870) ("I want at least a minority representation in the board of control, and that is all that is sought here"); 4 Debates of the Convention to Amend the Constitution of Pennsylvania 605 (1872) ("A private contract or understanding, by which the affairs of the corporation are managed directly to the interest of an individual or a combination of individuals, is almost always secret. The great mass of the stockholders at the time the arrangement is made know nothing about it."). See generally 50 N.W. Univ. L. Rev. 112 (1955).
the legislators saw no conflict between mandatory cumulative voting and classification.\textsuperscript{39} Even subsequent to the adoption of the cumulative voting right, the effective exercise of that right could be limited by corporate action reducing the size of the board\textsuperscript{40} or providing for the removal of a director by majority vote of the shareholders,\textsuperscript{41} thereby making it more difficult for the cumulatively voting shareholder to secure or retain representation on the board. It is submitted that the extrinsic evidence of intent justifies the conclusion that constitutional cumulative voting provisions were not intended to assure the shareholder proportional representation on the board.

IV. Conclusion

In view of the ambiguous language of constitutional cumulative voting provisions, and the absence of substantial extrinsic evidence that the constitutional framers intended proportional representation, it is believed that there is no necessary inconsistency between such provisions and classification of the board.\textsuperscript{42} Unless classification completely eliminates minority rights,\textsuperscript{43} a sufficiently large

\textsuperscript{39} A contemporaneous legislative exposition of a constitution is entitled to great weight in determining the meaning of the constitutional provisions. Cohen v. Commonwealth, 6 Wheat. (19 U.S.) 264 (1821).

\textsuperscript{40} Bond v. Atlantic Terra Cotta Co., 137 App. Div. 671, 122 N.Y.S. 425 (1910), affd. per curiam 210 N.Y. 587, 104 N.E. 1127 (1914). But see Curran, "Minority Stockholders and the Amendment of Corporate Charters," 32 Mich. L. Rev. 743 (1934). Statutes of California and Michigan would prohibit such reduction when a substantial minority objects. Cal. Corp. Code Ann. (1953) \S\S 501 (providing that the number of directors cannot be reduced below five without the consent of more than 80\% of the voting power; the dissenting 20\% would be able to elect cumulatively one director on a board of five); Mich. Comp. Laws (1948) \S 450.13 (preventing reduction of the number of directors where the dissenting minority would not be able to elect cumulatively the same number of directors on the reduced board).

\textsuperscript{41} Where the corporation has provided for cumulative voting, however, it is doubtful whether a minority director could be removed without cause. Matter of Rogers Imports, 202 Misc. 761, 116 N.Y.S. (2d) 106 (1952), noted in 51 Mich. L. Rev. 744 (1953) (an amendment to the certificate of incorporation providing for cumulative voting invalidated a previous by-law authorizing removal of a director without cause by a majority of the stock). Statutes sometimes prevent removal of a director where the removal is opposed by a number of share votes sufficient for his election. See, e.g., Mich. Comp. Laws (1948) \S 450.13.

\textsuperscript{42} The \textit{Model Business Corporations Act} \S\S 31, 35 (1950) provides for both mandatory cumulative voting and classification of directors.

\textsuperscript{43} The cumulative voting right would be entirely negated where the corporation provided for only one director in each class. Compare Wright v. Central Calif. Colony Water Co., 67 Cal. 582, 8 P. 70 (1885) (resolution authorizing the election of only one director at each election held unconstitutional) with Humphrys v. Winous Co., 165 Ohio St. 45, 138 N.E. (2d) 780 (1956) (amendment to articles providing for election of only one director at each election held not inconsistent with statutory cumulative voting right). Such corporate action is unlikely in view of classification statutes which commonly require a minimum number of directors in each class. See, e.g., Ohio Rev. Code (Baldwin, Supp.
minority has the opportunity to secure representation even on a classified board.44 Such an opportunity, and not proportional representation, was the intended object of constitutional cumulative voting provisions.45

William R. Luney, S.Ed.

1956) §1701.57 (enacted after the Humphrys decision to require a minimum of three directors in each class).

44 In Wolfson, a minority holding 25% of the shares plus one share could elect one director in a three director (of nine) election. In Janney, a minority holding approximately 11% of the shares could elect one director in an eight director (of sixteen) election. See note 4 supra.