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CORPORATIONS--DIRECTORS--APPLICATION TO NEWLY CREATED DIRECTORSHIPS OF STATUTORY PROVISIONS FOR FILLING VACANCIES

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CORPORATIONS—DIRECTORS—APPLICATION TO NEWLY CREATED DIRECTORSHIPS OF STATUTORY PROVISIONS FOR FILLING VACANCIES—Only thirteen states have statutes specifying who may fill directorships created by an increase in the board.¹ However, twenty-eight others provide by statute that the board is or may be empowered to fill vacancies.² The question whether such a provision permits the board to fill directorships arising on an increase in the board was before the Delaware court in the recent case of *Johnston v. Automatic Steel Products, Inc.*³ The by-laws specified that an increase in the board created vacancies which the board could fill. The board acted thereunder, and this action and the by-law were challenged. The court held that "vacancies" as used in the Delaware statute⁴ did not encompass newly created directorships, and that the shareholders could not empower the board to fill these positions without statutory authority. As the construction of the term "vacancies" is an open question in twenty-five of the states an examination of the question seems fitting.

A. History

The first case involving this question was *In re A. A. Griffing Iron Co.*,⁵ decided by the New Jersey court. At a special meeting, the shareholders increased the number of directors and elected additional directors to fill these positions. The election was challenged on the ground that these were "vacancies" and that the directors had exclusive power to fill them. The court not only held that the shareholders could fill the positions, but declared that the directors could not because they were not "vacancies" in the meaning of the statute or the by-laws of the corporation. The statutory provision, ". . . any vacancy occurring

¹ Arkansas, Dig. (Pope, 1937) § 2193; California, Civ. Code (Deering, 1948) § 806; Florida, Stat. (1941) § 612.31; Illinois, Rev. Stat. (1947) c. 32, § 157.36; Indiana, Ann. Stat. (Burns, 1933) § 25-208; Louisiana, Gen. Stat. (Dart, 1939) § 1114; Maryland, Ann. Code (Flack, 1939) Art. 23, § 14; Nevada, Comp. Laws (Hillyer, 1929) § 1632; New York, 58 Consol. Laws (McKinney, 1940) § 55; Ohio, Gen. Code Ann. (Page, 1938) § 8623-56; Tennessee, Code Ann. (Williams, 1934) § 3744; West Virginia, Code Ann. (1943) § 3032; Wisconsin, Stat. (1947) c. 180.13(1).

² Two states have provisions that vacancies shall be filled as the by-laws provide: Maine, Rev. Stat. (1944) c. 49, § 22; Wyoming, Comp. Stat. Ann. (1945) § 44-109. Five states have no provision concerning vacancies: Arizona, Iowa, Mississippi, New Hampshire, South Carolina.

³ (Del. Ch. 1948) 60 A. (2d) 455.

⁴ General Corporation Law, § 30, Rev. Code (1935) § 2062: "Vacancies shall be filled by a majority of the remaining directors, though less than a quorum, unless it is otherwise provided in the Certificate of Incorporation or the by-laws and the directors so chosen shall hold office until the next annual election and until their successors shall be duly elected and qualified, unless sooner displaced. . . ."

⁵ 63 N.J.L. 168, 41 A. 931 (1898).

. . . by death, resignation, removal or otherwise . . ."⁶ was held inapplicable to newly created directorships, although no reason was given for the holding. The by-law provision was held even more inapplicable, because it contained the phrase "unexpired term" which was interpreted to presuppose a previous incumbent.⁷ A vacancy statute was next construed by the Connecticut court in *Gold Bluff Mining and Lumber Co. v. Whitlock*.⁸ This was an action to enjoin a special meeting called to increase the board and to elect additional directors. The court stated that the board had no power to fill such directorships. The phrase in the statute, ". . . for the unexpired portion of the term"⁹ was held to imply a previous incumbency.¹⁰

On the basis of these two cases the text writers declared the rule that power to fill vacancies did not include the power to fill newly created directorships.¹¹ When the *Johnston* case¹² was decided, the American law rested on these two decisions, dating from the turn of the century, and the text statements based thereon.¹³ The court based its decision in the *Johnston* case solely on prior Delaware cases, in which the point had been conceded or assumed on the authority of the New Jersey and Connecticut decisions.¹⁴

B. Construction of "Vacancy"

The meaning of "vacancy" in the corporation statutes is, theoretically, a question of legislative intent. In this connection it is of interest that of the thirteen statutes which specifically provide for

⁶ N.J. Corp. Act, § 15, N.J. Laws (1896) p. 77.

⁷ 63 N.J.L. 168 at 173, 41 A. 931 (1898).

⁸ 75 Conn. 669, 55 A. 175 (1903).

⁹ Conn. Gen. Stat. (1902) § 3366.

¹⁰ 75 Conn. 669 at 674, 55 A. 175 (1903).

¹¹ 2 MACHEN, MODERN LAW OF CORPORATIONS, § 1403 (1908); 3 COOK, CORPORATIONS, 8th ed., § 624 (1923); 2 THOMPSON, LAW OF CORPORATIONS, 3d ed., § 1183 (1927); 2 FLETCHER, CYC. CORP., perm. ed., § 286 (1931).

¹² (Del. Ch. 1948) 60 A. (2d) 455.

¹³ This point was involved in one other case, *In re Vicksburg Bridge*, (D.C. Miss. 1937) 22 F. Supp. 490, a bankruptcy proceeding in which the validity of a bond issue was challenged on the ground that the board was not properly constituted. The first elected directors, three in number, had resigned effective the following day, and elected their successors and two additional directors to occupy the five positions specified in the by-laws. The court, applying Delaware law [General Corporation Law, § 30, Rev. Code (1935) § 2062], held the board properly constituted, but it does not appear whether the question of the power of the board to elect the two additional directors was raised. If all five directors authorized the bond issue, the point would not have been material.

¹⁴ *Moon v. Moon Motor Car Co.*, 17 Del. Ch. 176, 151 A. 298 (1930) (the point was conceded); *McWhirter v. Washington Royalties Co.*, 17 Del. Ch. 243, 152 A. 220 (1930) (assumed); *Gow v. Consolidated Coppermines Corp.*, 19 Del. Ch. 172, 165 A. 136 (1933) (assumed).

filling new directorships, such provisions are included in the vacancy section of each statute, and in eleven of the statutes these new positions are termed "vacancies."¹⁵

In view of the few American decisions construing the vacancy provisions of the corporation statutes, consideration of similar statutes is helpful. The Canadian corporation statute is comparable, for it makes no provision for filling new directorships, but does permit the directors to fill vacancies.¹⁶ It appears that this statute is treated as though "vacancy" includes new directorships,¹⁷ but as no Canadian decision on the question has been found, this practice is of limited significance.

An analogous situation is encountered with respect to statutes providing for filling vacancies in public offices. It has frequently been contended that "vacancy" as used in such statutes does not include newly created offices, but the courts are virtually unanimous in rejecting this contention.¹⁸ To hold that a new office is not "vacant" the courts require some positive showing that the vacancy statute was not intended to apply to the particular office.¹⁹

With respect to the corporation statutes, it is clear that the attitude of the courts has been quite different. In the Delaware statute there is nothing to indicate that "vacancy" was not intended to include new directorships.²⁰ In the Connecticut statute the phrase, ". . . for the unexpired portion of the term"²¹ was seized upon by the court as implying a previous incumbency.²² In the New Jersey case, *In re A. A. Griffing Iron Co.*,²³ the court did not even explain why the

¹⁵ Note 1, supra. Illinois and New York do not so specify.

¹⁶ Companies Act 1934, 24 & 25 Geo. 5, c. 33, § 90c, states: "In the absence of other provisions in that behalf in the letters patent, supplementary letters patent or by-laws of the company, (c) so long as a quorum of directors remains in office, any vacancy occurring in the board of directors may be filled from among the qualified shareholders of the Company, for the remainder of the term, by such directors as remain in office. . . ." Substantially the same provision was in the Act of 1927, Dominion Companies Act, R.S.C. 1927, c. 27, § 106c.

¹⁷ MASTEN AND FRASER, COMPANY LAW OF CANADA, 4th ed., 567 (1941).

¹⁸ *State v. Kiburz*, (Mo. 1947) 208 S.W. (2d) 285; *State v. Dixon*, (La. App. 1941) 4 S. (2d) 591; *People v. Hylan*, 212 N.Y. 236, 106 N.E. 89 (1914). See the thorough discussion of the meaning of "vacancy" in *Walsh v. Commonwealth*, 89 Pa. 419 at 425 (1879).

¹⁹ The statute creating the office conflicted in its provisions with the vacancy statute, *State v. Halladay*, 52 S.D. 497, 219 N.W. 125 (1928) (conflict in date of expiration of the term). The office did not come into existence until the next occurring election at which it was to be filled, *State v. Dixon*, (La. App. 1941) 4 S. (2d) 591 (police jurors); *People v. Opel*, 188 Ill. 194, 58 N.E. 996 (1900) (clerk of probate court).

²⁰ Note 4, supra.

²¹ Conn. Gen. Stat. (1902) § 3366.

²² 75 Conn. 669 at 674, 55 A. 175 (1903).

²³ 63 N.J.L. 168, 41 A. 931 (1898).

statute did not include new directorships. It is apparent that the reason for the decisions in the corporation cases must be sought elsewhere than in the vacancy provisions of the statutes. One clue to the reason is that in the two cases which established the "rule," the challenge was to action by the shareholders. The courts may have believed that they were benefiting the shareholders; more broadly stated, the decisions may have been based on "policy reasons."

C. *Considerations of Policy*

It appears that there are strong practical reasons for permitting the directors to fill newly created directorships. This is evidenced by the existence of the practice in England,²⁴ in Canada, and in twelve of the thirteen states which specifically provide for filling such positions.²⁵ Where the right is reserved to the shareholders alone, electing additional directors may be inconvenient. A survey of 200 large non-financial corporations²⁶ showed that 14 had more than 100,000 shareholders of voting stock. One had in excess of 640,000, and another more than 500,000. Of these 200 corporations, 164 had 1,000,000 or more shares of voting stock.²⁷ The problems involved in calling a special meeting to elect additional directors in such corporations would be considerable. In small companies having few shareholdings,²⁸ a requirement that a special meeting be called may be but a formality.²⁹

Construing the vacancy provision to include newly created directorships will have a minimal effect on control of the corporation. The balance of control in the board could be affected only to the extent

²⁴ Companies Act of 1929, 19 & 20 Geo. 5, c. 23, Table A, cl. 79.

²⁵ Note 1, *supra*. The Illinois Constitution (1870) does not permit the directors to fill vacancies. *People v. Cohn*, 339 Ill. 121, 171 N.E. 159 (1930), holding invalid the statute of 1919, which provided that the directors should fill vacancies, because conflicting with Art. XI, § 3, which provides for cumulative voting in elections of directors and declares that they "shall not be elected in any other manner."

²⁶ THE DISTRIBUTION OF OWNERSHIP IN THE 200 LARGEST NONFINANCIAL CORPORATIONS, T.N.E.C. Monograph No. 29 (1940).

²⁷ *Id.*, Appx. III, pp. 206-231.

²⁸ "In 1922, the only year for which such information is available, about one-half of a representative sample of companies had less than a dozen stockholders." THE DISTRIBUTION OF OWNERSHIP IN THE 200 LARGEST NONFINANCIAL CORPORATIONS, T.N.E.C. Monograph No. 29, p. 15, note 32 (1940).

²⁹ The corporation in the principal case, Automatic Steel Products, Inc., as of Dec. 31, 1947 had 975 shareholdings. One holding comprised 40 per cent of the shares (85,900 of 212,513 outstanding, 215,018 issued). MOODY'S MANUAL OF INVESTMENTS, INDUSTRIALS 524 (1948). As the board would normally be responsive to the wishes of this 40 per cent holding, and as such a holding should assure voting control, it would appear that election of additional directors by the board would give the same result as an election by the shareholders, and denying the board the power would accomplish nothing.

that a majority might solidify its position, and this may be to the advantage of the corporation by making possible a consistent managerial policy until the next election. Nor would the objective of cumulative voting be defeated, since that objective is minority representation on the board,³⁰ and this would be preserved.

One means of control by shareholders over the incumbent directors is the shareholders' power to increase the board and fill the new directorships.³¹ Construing the vacancy provision to include new directorships might result in loss of this control. This would be the result where the vacancy statute denies the shareholders the power to fill vacancies,³² or where the action of the board raises the number of directors to the maximum and the shareholders cannot alter this maximum.³³

D. Conclusion

Granting to the board the power to fill new directorships is not a recent innovation. An English case, decided in 1882, concerned a "company" in which the directors had this power, although the validity of the power was not questioned.³⁴ The English Companies Act of 1908 expressly provided that the directors were so empowered unless it was otherwise provided in the articles.³⁵ This provision is included in the Act of 1929³⁶ and has not been altered by the amendments of 1947.³⁷ This English position, together with that of Canada and the twelve American states, indicates that the practice of the directors filling newly created directorships is sound. There is authority in analogous fields for construing "vacancy" as including newly created offices, and the language in the corporation statutes is not inconsistent with this construction. The only objection to this interpretation appears to be that the shareholders may be deprived of a check on the directors through loss of the power to increase the board and fill the positions

³⁰ Bowes and DeBow, "Cumulative Voting at Elections of Directors of Corporations," 21 MINN. L. REV. 351 at 353 (1937).

³¹ For difficulties in removing directors see BALLANTINE, CORPORATIONS, rev. ed., § 187 (1946).

³² As in Alabama, Ala. Code (1940) tit. 10, § 24; *Moses v. Tompkins*, 84 Ala. 613, 4 S. 763 (1887). In *Blair Open Hearth Furnace Company, Ltd. v. Reigart*, 108 L.T. 665 (1913), the English court held that a provision in the articles that the board could appoint additional directors barred the shareholders from the power. More recent cases cast doubt on the validity of this decision. See 83 SOL. J. 449 (1939).

³³ As in Texas where the statute prescribes the maximum number, Tex. Rev. Civ. Stat. (1925) § 18-2-5.

³⁴ *The York Tramways Company, Ltd. v. Willows*, 8 Q.B.D. 685 (1882).

³⁵ 8 Edw. 7, c. 69, Table A, cl. 85.

³⁶ 19 & 20 Geo. 5, c. 23, Table A, cl. 79.

³⁷ Companies Act of 1947, 10 & 11 Geo. 6, c. 47.

created. In jurisdictions where this would not be the result and where the "vacancy" statute has not yet been interpreted, it is submitted that the statute should be construed to permit the board to fill newly created directorships.

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