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## CORPORATIONS--SHAREHOLDERS-EFFECT ON VOTING TRUST AGREEMENT OF INABILITY TO TRANSFER SHARES TO THE VOTING TRUSTEES

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CORPORATIONS—SHAREHOLDERS—EFFECT ON VOTING TRUST AGREEMENT OF INABILITY TO TRANSFER SHARES TO THE VOTING TRUSTEES—Plaintiff filed a petition in equity attacking his removal as a director and president of the defendant corporation on the grounds that such removal was brought about through the exercise of an alleged invalid voting trust agreement. The plaintiff and another shareholder, each owning fifty per cent of the stock in the defendant corporation, had entered into a voting trust agreement by which they appointed themselves and a third party as voting trustees. At the time the trust agreement was executed, all of the stock was on deposit with an escrow agent subject to an existing escrow contract. Plaintiff challenged the validity of the voting trust agreement on the ground that the stock was not deposited with or transferred to the voting trustees as required by section 18 of the General Corporation Law.<sup>1</sup> The lower court sustained the petition on the basis that the voting trust agreement was invalid. On appeal, *held*, affirmed. The provisions of the voting trust statute are mandatory and non-compliance is not excused by impossibility. *Smith v. Biggs Boiler Works Co.*, (Del. Ch. 1951) 82 A. (2d) 872.

<sup>1</sup>Del. Rev. Code (1935) §2050: "One or more stockholders may by agreement in writing deposit capital stock of an original issue with or transfer capital stock to any person . . . or corporation . . . authorized to act as trustee, for the purpose of vesting in said person . . . who may be designated Voting Trustee . . . the right to vote thereon for any period of time . . . not exceeding ten years. . . ."

Although there is a general conflict as to the validity of voting trusts,<sup>2</sup> the Delaware court had not had occasion to rule upon the question prior to the enactment of that state's first voting trust statute in 1925.<sup>3</sup> Therefore, the Delaware judiciary could interpret the statute unaided and unhampered by considerations of local common law.<sup>4</sup> It has been consistently held that section 18 of the General Corporation Law occupies the entire field of voting trusts and that compliance with the provisions of that section is mandatory.<sup>5</sup> This doctrine of statutory interpretation has been applied to defeat voting trusts which attempted to avoid the transfer of shares for the purpose of saving the transfer tax<sup>6</sup> and which attempted to extend the duration of the trust beyond the statutory limit.<sup>7</sup> The principal case appears to call for no special consideration except for the fact that here compliance with the statutory provisions was impossible, whereas in the previous cases non-compliance was due either to negligence or intentional circumvention. The court determined, in the principal case, that inability to transfer to the voting trustees did not excuse compliance with the statute. Thus, the "impossibility" situation was included as subject to the mandatory provisions in a strictly logical extension of an already firmly established principle of interpretation. This position obliged the court to answer the obvious argument that had the legislature desired to exclude stock in escrow from being the subject of a voting trust, it would have so expressly provided. The court countered with reference to a prior decision<sup>8</sup> which held that the voting trust statute did not purport to deal with or exclude other types of agreements whereby shareholders might contract with each other as to how to vote their shares. Since the owners of shares in pledge or escrow could effect the

<sup>2</sup> The earlier cases held that the mere separation of voting power from beneficial ownership rendered the trust invalid because contrary to public policy. *Shepaug Voting Trust Cases*, 60 Conn. 553, 24 A. 32 (1890). This view has been modified gradually to the extent that usually voting trusts are no longer held unlawful per se. Their validity today depends generally upon the legitimacy of the purpose for which they are formed. *Boyer v. Nesbitt*, 227 Pa. 398, 76 A. 103 (1910). See collection of cases in 16 L.R.A. (n.s.) 1136 (1908), and 105 A.L.R. 123 (1936).

<sup>3</sup> 34 Del. Laws (1925) c. 112, §6.

<sup>4</sup> While in *Mackin v. Nicollet Hotel, Inc.*, (8th Cir. 1928) 25 F. (2d) 783, a voting trust formed prior to the enactment of the statute and consisting of stock in a Delaware corporation was declared invalid, a federal decision does not bind a state court in determining its common law.

<sup>5</sup> The question of statutory interpretation was presented in *In re Chilson*, 19 Del. Ch. 398, 168 A. 82 (1933), but a definite policy was not declared until *Perry v. Missouri Kansas Pipe Line Co.*, 22 Del. Ch. 33, 191 A. 823 (1937). In the later case the court quoted from *In re Morse*, 247 N.Y. 290 at 298, 160 N.E. 374 (1928), in which a similar question was involved: "The test of validity is the rule of the statute. When the field was entered by the Legislature it was fully occupied and no place was left for other voting trusts. . . ."

<sup>6</sup> *In re Chilson*, 19 Del. Ch. 398, 168 A. 82 (1933).

<sup>7</sup> *Perry v. Missouri Kansas Pipe Line Co.*, 22 Del. Ch. 33, 191 A. 823 (1937); *Appon v. Belle Isle Corp.*, 29 Del. Ch. 122, 46 A. (2d) 749 (1946).

<sup>8</sup> *Ringling Brothers—Barnum and Bailey Combined Shows v. Ringling*, 29 Del. Ch. 610, 53 A. (2d) 441 (1947).

same result by another type of voting agreement, the argument that the legislature must have intended an exception to the absolute language of the voting trust statute loses its force. The principal case reaffirms<sup>9</sup> the necessity of strict compliance with the provisions of the voting trust statute and serves notice on draftsmen to make certain such compliance is possible.<sup>10</sup>

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<sup>9</sup> In *Tracey v. Franklin*, (Del. Ch. 1948) 61 A. (2d) 780, the validity of a voting trust was attacked upon two grounds: (1) It was an unlawful restraint on alienation because the voting trust certificates were made non-transferable, (2) a copy of the trust agreement was not filed with the Delaware office of the corporation as required by statute. The court chose to invalidate the trust on the basis of inalienability rather than on the seemingly easy basis of statutory non-compliance. Was this a hint that the court may not have been willing to follow the precedent of strict statutory compliance? On the other hand, the cases appear to indicate a definite tendency on the part of the courts to avoid the de jure—de facto distinction present in other phases of corporation law.

<sup>10</sup> For the interesting problem as to whether the parties in the principal case could have achieved the desired result by any other type of voting agreement, see 46 MICH. L. REV. 70 (1947).