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CORPORATION-OFFICERS AND DIRECTORS-RELATIONSHIP BETWEEN CUMULATIVE VOTING AND REMOVAL PROVISIONS

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CORPORATIONS—OFFICERS AND DIRECTORS—RELATIONSHIP BETWEEN CUMULATIVE VOTING AND REMOVAL PROVISIONS—Respondent corporation adopted a bylaw providing for removal of a director, with or without cause, by majority vote of the stockholders. The corporation subsequently amended its charter to provide for cumulative voting at all elections of directors. At a meeting of the stockholders and directors, one director was removed without cause by majority vote of the stockholders and another director elected in his place over the objection of petitioner, a minority stockholder owning 40% of the outstanding stock. On petitioner's application to have the election set aside, *held,* election

invalidated and set aside. Adoption of the cumulative voting provision invalidated the bylaw insofar as it provided for removal of a director without cause. *In re Rogers Imports, Inc.*, (N. Y. 1952) 116 N. Y. S. (2d) 106.

The principal case is illustrative of the conflict that can arise between a provision that permits the minority stockholders to cumulate their votes, thereby assuring them representation on the board of directors, and other provisions that make the legal effects of stockholder action dependent on majority determination. In the instant case, the conflict involved the provision for cumulative voting and another provision for removal of directors without cause by majority vote.[1] Thus, if both provisions were allowed to stand side by side, the majority could remove the minority's representatives on the board and replace them with their own representatives, thereby defeating the effect of the cumulative voting provision. Consequently, when a situation of this nature arises it is necessary to ascertain which provision is controlling.[2] When a judicial determination of this question is required, it is invariably the minority stockholders who must seek it, for unless the provision allowing majority determination is stricken down, it will render the cumulative provision ineffective. The initial question raised by such a case concerns the relative grade of authority of each provision, i. e., constitutional, statutory, corporate article, or bylaw. It seems generally agreed that the cumulative voting right cannot be taken away by an authority inferior to that by which it was granted.[3] Thus, in the many states where cumulative voting is made mandatory either by constitutional or statutory provision,[4] it would seem unlikely that the right to cumulate could be effectively undercut by a conflicting article of incorporation or bylaw.[5] Similarly, where the cumulative voting provision is permissive, it has been held that the adoption of a cumulative voting scheme in the corporate charter can be amended by an authority of equal grade.[6] The decision in the principal case meshes with this analysis, for when the court concluded that a cumulative voting provision, adopted by the corporation pursuant to a permissive

[1] The conflict may also arise as a result of the majority's attempted use of its power to adjourn a meeting to defeat the effect of the cumulative provision, West Side Hospital of Chicago v. Steele, 124 Ill. App. 534 (1906); through the attempted use of the majority's control of the chair, Chicago Macaroni Mfg. Co. v. Boggiano, 202 Ill. 312, 67 N.E. 17 (1903); or as a result of an attempted resolution passed by the majority, Commonwealth ex rel. Oler v. Gutman, 10 Pa. D. & C. 606 (1927).

[2] A related problem arises when the majority in interest attempts to change its vote or hold another election because it is suddenly realized that the minority is using or has used its right to cumulate to gain control of the board. On this problem, see Zachary v. Milin, 294 Mich. 622, 293 N.W. 770 (1940) and the cases noted in 13 A.L.R. 131 (1921).

[3] Laughlin v. Geer, 121 Ill. App. 534 (1905); Tomlin v. The Farmers & Merchants Bank, 52 Mo. App. 430 (1893).

[4] For a list of the states in which cumulative voting is made mandatory and those in which it is permissive, see Young, "The Case for Cumulative Voting," 1950 WIS. L. REV. 49 at 54 (1950).

[5] See cases cited supra note 3.

[6] Maddock v. Vorclone Corporation, 17 Del. Ch. 39, 147 A. 255 (1929).

statute, was in conflict with a previously adopted corporate provision for director removal,[7] it did not hesitate to hold that the subsequent provision of equal or superior grade invalidated the prior removal provision to the extent that the two provisions were in conflict.[8] However, it should be noted that the problem presented by a case of this nature is likely to be more difficult in some jurisdictions where additional factors must be considered. In some states, there are statutory provisions permitting removal of directors by a specified percentage of the stockholders in interest standing side by side with cumulative voting provisions which are mandatory in nature.[9] Whether these provisions will be held to be conflicting and, if so, which shall prevail, has apparently not yet been decided by the courts. Where the privilege to cumulate is granted by the state constitution, it would seem likely that the removal statute would not be allowed to defeat the intended effect of the constitutional provision. Where the cumulative voting right is conferred by statute, it may well be argued that the high percentage vote required by the removal provision affords sufficient protection against undue invasions of the cumulative voting privilege, and, therefore, that the removal statute was intended to prevail in the rare case in which it permits a result that is contrary to that of the cumulative voting provision.[10] Consideration of an additional factor may also be necessary in states that have neither a statutory removal provision nor a cumulative voting provision of a mandatory nature. While there seems to be little solid authority on the point,[11] there is some indication that removal by a majority stock interest might be precluded in some of these states on common law principles.[12] Thus, a corporate adopted provision permitting removal by a majority in interest may not be effective in undercutting a previously adopted cumulative voting provision of like grade. Under these circumstances, the majority could only defeat the effect of the cumulative voting privilege by amending the provision by which

[7] The court concluded that it was merely through an oversight that the removal bylaw was not appropriately amended when the cumulative provision was adopted, and, accordingly, that the proper qualification should be read into the bylaw. In support of this conclusion the court noted that the right to cumulate is protected in several states by imposing statutory limitations on removal proceedings, e.g., Cal. Civ. Code (Deering, Corp. C.A., 1948) §810.

[8] The decision was expressly limited to the case of removal without cause, it being felt that it was only to this extent that the two provisions were inconsistent.

[9] See Bowes and DeBow, "Cumulative Voting at Elections of Directors of Corporations," 21 MINN. L. REV. 351 at 367 (1937).

[10] For example, the Montana statute provides for removal by a vote of stockholders holding two-thirds of the capital stock. 2 Mont. Rev. Code (1947) §15-408.

[11] A case which holds that a bylaw providing for removal by majority determination is invalid because contrary to a mandatory constitutional or statutory provision conferring the right to cumulate is limited in its value as case authority to the proposition that the cumulative voting right cannot be taken away by an authority inferior to that by which it was conferred, e.g., Laughlin v. Geer, supra note 3.

[12] See Koski v. Kylmanen, 178 Minn. 164, 226 N.W. 401 (1929); Powers v. Blue Grass Building & Loan Assn., (Ky. 1898) 86 F. 705; Bowes and DeBow, supra note 9 at 367 and 368.

it was conferred.[13] While New York has neither a statutory removal provision nor mandatory cumulative voting provision, consideration of the validity of the removal bylaw on the basis of common law principles was not pursued in the principal case since previous New York cases have clearly indicated that in that state, at least, a bylaw provision providing for removal without cause by majority determination can be an effective corporate regulation under proper circumstances.[14]

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[13] Maddock v. Vorclone Corporation, supra note 6.

[14] "[A] corporation may adopt a by-law providing for the removal of a director with or without cause, but such by-law, in so far as it refers to the removal of a director without cause, is of no value for the removal of a director who is in office at the time of enactment of the by-law." Abberger v. Kulp, 156 Misc. 210 at 212, 281 N.Y.S. 373 (1935).