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CORPORATIONS-SHAREHOLDERS' VOTING AGREEMENTS-DRAFTING PRECAUTIONS

LeRoy H. Redfern S.Ed.
University of Michigan Law School

CORPORATIONS—SHAREHOLDERS' VOTING AGREEMENTS—DRAFTING PRECAUTIONS—According to most authority shareholders may make a legal and enforceable contract to vote their shares as a unit for the election of directors. Such contracts, it is generally agreed, are valid if they do not limit the discretion of directors, contemplate fraud, violate any statutory, constitutional, by-law, or charter provision, or operate to oppress other stockholders.[1] A few courts, however, remain committed to the outmoded doctrine that each shareholder owes a duty to every other shareholder to vote his own stock, and that therefore pooling agreements are invalid per se.[2] Further comment on the fallacy of maintaining such a position in view of modern business conditions is not

[1] Faulds v. Yates, 57 Ill. 416 (1870); Brightman v. Bates, 175 Mass. 105, 55 N.E. 809 (1900); Weber v. Della Mountain Min. Co., 14 Idaho 404, 94 P. 441 (1908); White v. Snell, 35 Utah 434, 100 P. 927 (1909); Winsor v. Commonwealth Coal Co., 63 Wash. 62, 114 P. 908 (1911); Thompson v. Thompson, 279 Ill. 54, 116 N.E. 648 (1917); Manson v. Curtis, 223 N.Y. 313, 119 N.E. 559 (1918); In re Pittock's Will, 102 Ore. 159, 199 P. 633 (1921); Stott v. Stott, 258 Mich. 547, 242 N.W. 747 (1932); Williams v. Fredericks, 187 La. 987, 175 S. 642 (1937); Trefethen v. Amazeen, 93 N.H. 110, 36 A. (2d) 266 (1944); Hart v. Bell, 222 Minn. 69, 23 N.W. (2d) 375, 24 N.W. (2d) 41 (1946); Rogers, "Pooling Agreements Among Stockholders," 19 YALE L. J. 345 (1910); Wormser, "The Legality of Corporate Voting Trusts and Pooling Agreements," 18 COL. L. REV. 123 (1918); 66 U. S. L. REV. 562 (1932); 3 UNIV. CHI. L. REV. 640 (1936); 2 THOMPSON CORPORATIONS, 3d ed., § 1001 (1927); 5 FLETCHER, CYCLOPEDIA CORPORATION, perm. ed., § 2064 (1931); 13 AM. JUR., Corporations, § 500; 18 C.J.S. Corporations, § 551; BALLANTINE, CORPORATIONS rev. ed., § 183 (1946); 71 A.L.R. 1289 (1931).

[2] Haldeman v. Haldeman, 176 Ky. 635, 197 S.W. 376 (1917); Morel v. Hoge, 130 Ga. 625, 61 S.E. 487 (1908); see Roberts v. Whitson, (Tex. Civ. App. 1945) 188 S.W. (2d) 875 at 878.

a part of this writing, as the point has been thoroughly covered in a number of legal articles and judicial opinions.[3]

It has frequently been asserted by writers that the validity or invalidity of a voting agreement depends upon whether the object thereby sought to be attained is deemed worthy or unworthy by the court.[4] From this it might appear that there is no problem in enforcing such an agreement if its purpose is legal, but an examination of the cases reveals that even though a particular agreement is for a proper purpose, when a breach or attempted revocation occurs, the innocent party not infrequently discovers that in practical effect the agreement is nugatory.[5] The object of this comment is to consider some of the problems in drafting a pooling agreement so that the courts will carry into effect the vote as provided for in the agreement even though there is an attempted revocation or breach.

Three cases are given special attention—an early California decision, *Smith v. San Francisco and N. P. Ry Co.;*[6] a comparatively late opinion of the Texas Court of Civil Appeals, *Roberts v. Whitson;*[7] and a recent decision of the Supreme Court of Delaware, *Ringling Bros.-Barnum and Bailey Combined Shows, Inc. v. Ringling.*[8] These cases have been singled out because they clearly show the danger of assuming that so long as the voting contract is for a legal object the drafter has no problem, and a majority of courts will enforce it. The agreements involved are similar and at first glance may appear indistinguishable; nevertheless, technical differences in the agreements brought about contrary results.

A. *Smith v. San Francisco & N. P. Ry. Co.*

Smith and two others purchased stock under an agreement that the stock should be voted in one block for a period of five years. The vote was to be determined by ballot among themselves. Smith, contending the agreement was invalid, attempted to cast his vote separately. The chairman of the meeting rejected it and counted the vote tendered on behalf of Smith by the concurring parties. Smith brought a bill in equity to have the election set aside. The California Supreme Court re-

[3] Finkelstein, "Voting Trust Agreements," 24 MICH. L. REV. 344 (1926); Burke, "Voting Trusts Currently Observed," 24 MINN. L. REV. 347 (1940); supra, note 1.

[4] 18 C.J.S., Corporations, § 551 (b), p. 1256; 71 A.L.R. 1289 at 1290 (1931).

[5] Gage v. Fisher, 5 N.D. 297, 65 N.W. 809 (1895); Gleason v. Earles, 78 Wash. 491, 139 P. 213 (1914); Ringling Bros.-Barnum and Bailey Com. Shows, Inc. v. Ringling, (Del. 1947) 53 A. (2d) 441; Roberts v. Whitson, (Tex. Civ. App. 1945) 188 S.W. (2d) 875.

[6] 115 Cal. 584, 47 P. 582 (1897).

[7] (Tex. Civ. App. 1945) 188 S.W. (2d) 875.

[8] (Del. 1947) 53 A. (2d) 441.

fused to do so, taking the position that the instrument executed by the parties was a proxy and authorized the vote in accordance with determination by two of the three parties. The court expressed this view in these words:

> "... if it [the proxy] was made upon a consideration sufficient to bind the parties to its enforcement, it must be regarded as still operative.... It may be assumed that neither of the parties would have entered into the transaction, or agreed upon the purchase of the stock, except upon these conditions, and it must be held that each contributed his money to the purchase of the stock upon the promise made to him by the others. There was thus a sufficient consideration for the agreement granting the right to vote the stock. It was in the nature of a power coupled with an interest, and, being given for valuable consideration, could not be revoked at the pleasure of either."[9]

The important point to note is that the contract did not expressly provide for a proxy, but the court found an implied proxy, irrevocable because it was in the "nature of a power coupled with an interest" and given for valuable consideration. It should also be observed that the purchase of stock on the basis of the promises, and not the mutual promises alone, was viewed as the consideration.

B. *Roberts v. Whitson*

Whitson and two others entered into an agreement to vote their stock as a block and provided that in case of disagreement the controversy should be submitted to arbitration. Each party was to appoint an arbitrator, the three to select two more, the majority of the five to decide the issue involved, after which stockholders were to vote their stock accordingly. One party repudiated the agreement and another declined to appoint an arbitrator as requested by Whitson. Whitson instituted suit for injunction asking the court to compel compliance with the agreement. The court held that the voting agreement was revocable and having been revoked was no longer in force; furthermore, it viewed the agreement as a derogation of the laws of the state controlling corporations, against public policy, and void.

The position taken appears somewhat inconsistent with the following language in the opinion:

> "... While it is true that, absent fraud, proxies and voting agreements are generally sustained, yet, if not coupled with an in-

[9] Smith v. San Francisco & N. P. Ry. Co., 115 Cal. 584 at 599-600, 47 P. 582 (1897).

terest or based upon consideration deemed valuable in law, are revocable; indeed, according to the weight of authority, an irrevocable proxy or power of attorney to vote stock, if not coupled with an interest, is contrary to public policy." [10]

Prior to this statement the court stated that the agreement was not based upon consideration deemed valuable in law.[11]

Mutual promises of parties to a contract are generally regarded as sufficient consideration for each other unless they are unlawful and therefore constitute no consideration whatever.[12] In spite of this fact no decision has been found, unless it be *Ringling Bros.-Barnum and Bailey Combined Shows, Inc. v. Ringling*, that holds mutual promises are sufficient consideration for a binding contract to vote stock.

The opinion in the instant case exemplifies a definite hostility toward voting agreements. It leaves doubt as to whether it would be possible to draft a voting agreement which the Texas Court would enforce. The court's concern over lack of consideration, or a "power coupled with an interest," may have been one means of disposing of the case at hand, for there is reason to believe that if faced with an agreement containing what is referred to loosely as a "power coupled with an interest" or what the court regards as legal consideration, the court would nullify it by resorting to the antique doctrine that each stockholder owes a duty to every other stockholder to vote his own stock.[13] On the other hand it may very well be that objections to the agreement in the principal case could be obviated by making it a part of a transaction in which other property rights changed, or a part of an agreement to purchase stock. Such arrangements have been viewed as satisfying the requirement of legal consideration or something in the nature of a "power coupled with an interest." [14]

The object sought by parties to the agreement in the principal case might have been reached by use of a voting trust. Although policy arguments relied upon to defeat pooling agreements might be used with equal persuasion against voting trusts, dictum in a recent Texas case suggests that a voting trust may be validly entered into between stockholders of a Texas corporation.[15]

[10] Roberts v. Whitson, (Tex. Civ. App. 1945) 188 S.W. (2d) 875 at 878.

[11] Id. at 877.

[12] 1 WILLISTON, CONTRACTS, rev. ed., § 103F (1936).

[13] Roberts v. Whitson, (Tex. Civ. App. 1945) 188 S.W. (2d) 875 at 878.

[14] Infra, note 27.

[15] Hamblem v. Horwitz-Texan Theatres Co., Inc., (Tex. Civ. App. 1942) 162 S.W. (2d) 455 at 457.

C. *Ringling Bros.-Barnum and Bailey Combined Shows, Inc., v. Ringling*

Mrs. Ringling and Mrs. Haley, two of three stockholders of defendant corporation, each owning approximately one-third of the stock, agreed to act jointly in exercising their voting rights. The agreement was to be in effect for a period of ten years. In the event that the parties failed to agree they bound themselves to vote as Mr. Loos, an arbitrator, should direct. The parties also agreed that each would have the right of first refusal on the other's stock. There was disagreement and Mr. Loos ordered both to vote for the directors Mrs. Ringling favored. Mrs. Haley refused to comply and by her vote succeeded in installing a different director. Mrs. Ringling brought suit to enforce the agreement. The chancellor decreed the election be set aside and the agreement be specifically performed at a new meeting of the shareholders.[16] He viewed the agreement as constituting the willing party an implied agent, possessing a "power coupled with an interest" to cast the particular vote. In the words of the chancellor, "a situation very similar in principle is presented and disposed of in this manner by the California Court in *Smith v. San Francisco and N. P. Ry. Co.*"[17]

The Delaware Supreme Court held the agreement valid but modified the order of the Court of Chancery by directing that upon application of Mrs. Ringling, the injured party, the votes representing Mrs. Haley's shares should not be counted. Its refusal to enforce the arbitrator's decision was justified on the basis that the agreement did not empower the arbitrator to carry his directions into effect and that nothing was contained in the agreement, or the actions of the parties, that could be construed to grant a power in either party to exercise the voting rights of the other. By interpreting the contract in this manner and not counting Mrs. Haley's votes an unusual result was reached.[18] This case should serve as a warning to the draftsman of pooling agreements to provide expressly for the power in the parties to vote for each other and not to depend upon the court to imply such a power.

The Delaware court seemed to take the position that if the pooling

[16] Ringling v. Ringling Bros.-Barnum & Bailey Com. Shows, Inc. (Del. Ch., Newcastle Co. 1946) 49 A. (2d) 603, noted in 60 HARV. L. REV. 651 (1947).

[17] Id., 49 A. (2d) 603 at 611.

[18] Mrs. Ringling and Mrs. Haley had 315 shares each and Mr. North had 370 shares. To be sure to elect five of seven directors, regardless of how Mr. North might vote, the combined votes had to be divided among five different candidates and it was essential both Mrs. Ringling and Mrs. Haley vote for at least one of the five. When Mrs. Haley's votes were rejected that left three directors elected by Mrs. Ringling and three by Mr. North, neither having voted more than three. Mrs. Haley was left in a position to nullify the effect of the agreement by declining to vote at the next election and making it possible for Mr. North, owning a few more shares than Mrs. Ringling, to place four of seven on the board of directors.

agreement provided for a power in each party to exercise the voting rights of the other the mutual promises would be sufficient consideration, and the decision of the arbitrator would be enforced. However, there are three reasons why a draftsman cannot afford to construe this decision as meaning that mutual promises of parties to a pooling agreement are legal consideration which will support a power in each party to exercise the voting rights of the others. First, this portion of the opinion was dictum. Second, the agreement gave the parties the right of first refusal in case the other party should sell her shares, and such a right has been viewed as in the nature of "a power coupled with an interest," or as the requisite consideration.[19] Third, in an earlier Delaware case the court indicated that a proxy or power to vote which was granted in a voting contract had to be "coupled with an interest," or the agreement was revocable.[20]

The end sought in the principal case might have been achieved by setting up a voting trust in accordance with the Delaware Statute authorizing voting trusts.[21] Mrs. Ringling and Mrs. Haley could have formed a voting trust, appointed their "arbitrator" as a third trustee, and provided in the trust instrument that all shares would be voted as determined by the majority of the trustees.[22]

D. *Drafting a Voting Agreement*

In drafting a voting agreement the draftsman should constantly bear in mind that there remains in many jurisdictions considerable

[19] Infra, note 29.

[20] In re Chilson, 19 Del. Ch. 398 at 408, 168 A. 82 (1933), "It seems that no one except a stockholder of record can vote at a corporate election of a Delaware corporation unless he be a voting trustee with whom stock has been deposited . . . a fiduciary, . . . a pledgor whose shares have been transferred to the pledgee without power to vote, or the holder of a valid and unrevoked proxy." The court distinguished a group of cases, among them Smith v. San Francisco & N.P.R. Co., on the ground that in those cases the agency authority was coupled with an interest.

[21] Del. Rev. Code (1935) c. 65, § 18, p. 467: "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 persons, or corporation or corporations authorized to act as trustee, for the purpose of vesting in said person or persons, corporation or corporations, who may be designated Voting Trustee or Voting Trustees, the right to vote thereon for any period of time determined by such agreement, not exceeding ten years, upon the terms and conditions stated in such agreement. Such agreement may contain any other lawful provisions not inconsistent with said purpose. . . ."

[22] The doctrine of merger of legal and equitable interests should prove no obstacle in creating such a trust. 2 TRUSTS RESTATEMENT, § 341(h) (1935) "Trustees and beneficiaries identical. Although the several beneficiaries of a trust become the trustees of the trust, or the trustees become the beneficiaries, the trust is not terminated." See Illustration 18, p. 1051 for a situation where *B*, *C*, and *D* hold in trust for *C* and *D*. Rankine v. Metzger, 69 App. Div. 264 at 269, 74 N.Y.S. 649 (1902); 1 BOGERT, TRUSTS AND TRUSTEES, § 129 (1935); 29 YALE L. J. 97 (1919).

hostility toward such a controlling device.[23] If the objective is merely to unite votes for the board of directors little difficulty should be experienced with contentions of fraud or illegal purpose. Although there is no valid reason why the mutual promises of the parties to the agreement are not sufficient to support it, the draftsman must face the fact that in most, if not all jurisdictions, something more is required to make it irrevocable.

In order to forestall litigation, and to insure enforcement of the contract in case of breach, the following precautions are recommended regardless of decisions which may appear to make them unnecessary:

(1) The agreement should state fully the legal purpose or purposes for which it is made.[24]

(2) The agreement should be created for a reasonable period of time. In no case should that period exceed the statutory time limit for proxies.[25] (If the statute provides that all proxies are revocable, resort should be made to the voting trust or some other means of control.)

(3) Each party should be empowered to vote the entire block of stock for the directors selected under the pooling agreement with it expressly stipulated that the power is irrevocable.[26]

(4) The agreement should spell out a valuable consideration other than the mutual promises of the parties.[27]

(5) When practicable, the parties to the agreement should be given a property or security interest in the shares of the other parties. The same effect should be had by making the contract a part of a transaction in which other property rights have changed, or a part of an agreement to purchase shares.[28] If it is not feasible to work in any of these relations, it may well be that providing for a right of first refusal in case of sale by a party to the agreement would create sufficient inter-

[23] Wormser, "The Legality of Corporate Voting Trusts and Pooling Agreements," 18 COL. L. REV. 123 (1918); 17 MINN. L. REV. 89 (1932); 3 UNIV. CHI. L. REV. 640 (1936).

[24] Washington and Fulda, "Protective Coloring in Corporation Law," 26 MINN. L. REV. 824 (1942); Burke, "Voting Trusts Currently Observed," 24 MINN. L. REV. 347 (1940).

[25] Simpson v. Nielson, 77 Cal. App. 297, 246 P. 342 (1926); 159 A.L.R. 307 at 312 (1945).

[26] Ringling-Bros. Barnum and Bailey Com. Shows v. Ringling, (Del. Ch., Newcastle Co. 1946) 49 A. (2d) 603, furnishes an excellent example of the advisability of this provision.

[27] Provide the court with a means of sustaining the agreement without breaking precedent or expressly overruling a prior deciison.

[28] BALLANTINE, CORPORATIONS, § 179, p. 410 (1946); Axe, "Corporate Proxies," 41 MICH. L. REV. 38 at 52 and 225 at 257 (1942); 159 A.L.R. 307 (1945).

est to satisfy the requirement of a "power coupled with an interest," and adequate consideration.[29]

LeRoy H. Redfern, S.Ed.

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[29] Boyer v. Nesbitt, 227 Pa. 398, 403, 76 A. 103 (1910); Ringling v. Ringling Bros.-Barnum and Bailey Com. Shows, (Del. Ch., Newcastle Co. 1946) 49 A. (2d) 603, noted in 60 HARV. L. REV. 651 (1947); 159 A.L.R. 307 (1945).