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A Threat to Cumulative Voting

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A THREAT TO CUMULATIVE VOTING

In his book on the law of private corporations,[1] Robert S. Stevens writes concerning the goal of cumulative voting.

> The purpose of cumulative voting is to enable minority shareholders to secure representation on the board by casting their cumulative votes for at least one candidate. Through the representation thus secured by the minority is insufficient to control directorate action, it does give the minority a representative who can observe and report upon the activities of those directors elected by majority shareholders.[2]

A modern corporation statute which seeks, on its face, to insure cumulative voting rights is the Model Business Corporation Act,[3] fostered by the American Bar Association. With slight modifications, the Model Act has been adopted in Wisconsin, Oregon and the District of Columbia, while the newly proposed Texas Act is a substantive adoption of the Model Act. Unquestionably, the Act will have great influence on many states currently considering revisions of their corporate statutes. While the Model Act presents itself as a "modern statute,"[4] a pattern for those states which seek revisions of their own codes—, it nonetheless has been severely criticized as to some of its provisions.[5] The provision for cumulative voting (§34) conforms to the ends pointed up by Mr. Stevens. But the section immediately following (§35) presents a serious threat to the fulfillment of the prior section—a threat entitled: "Classification of Directors".

The superficial purpose of classifying directors is to provide for some degree of continuity while new members of the board are being initiated into the organization. Thus some directors would carry over one or two years. Mathematically it is obvious that there are undesirable features in a classification system for the minority stockholder. If, for example, nine directors were to be elected, ten per cent

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[1] STEVENS, HANDBOOK OF THE LAW OF PRIVATE CORPORATIONS (Rev. 1936).

[2] *Id.* § 117.

[3] HANDBOOK A OF THE MODEL BUSINESS CORPORATION ACT (Rev. 1953) prepared by the COMMITTEE ON CORPORATE LAWS OF THE AMERICAN BAR ASSOCIATION, published by the COMMITTEE ON CONTINUING LEGAL Education.

[4] HANDBOOK A OF THE MODEL eq. BUSINESS CORPORATION ACT (Rev. 1950) prepared by the COMMITTEE ON CORPORATE LAWS OF THE AMERICAN BAR ASSOCIATION, published by the COMMITTEE ON CONTINUING LEGAL Education p. x.

[5] Harris, *The Model Business Corporation Act—Invitation to Irresponsibility?* 50 Northwestern L. Rev. 1-16 (1955).

plus one share could elect one director. If, on the other hand, three directors were to be elected, to elect one director would necessitate 25 per cent plus one share of a 100 per cent vote. The classification system as proposed by the Model Act, gives rise to an annual election of three directors, thus creating the possibility of no minority representation, which is the basic purpose of cumulative voting. As to the first answer usually given by supporters of the classification provision, that of providing continuity of management, statistics taken from leading corporations demonstrate that, "Historically, directors of corporations continue in office on the average over a decade".[6]

There is no case law on the question of the effects of a classification of directors provision on cumulative voting. But in a recent Illinois opinion, *Wolfson v. Avery et al.*,[7] affirmed by the highest court of the state, it was decided that the classification of directors provision in the Illinois Business Corporation Act is unconstitutional because it is inconsistent with the aims of cumulative voting as provided for in Article XI, Section 3 of the Illinois Constitution. Hence the election of all nine directors must be held at the Annual meetings; rather than one-third of the nine members, as had been provided in a by-law of the Montgomery-Ward Company. This by-law was founded on Section 3 of the Illinois Business Corporation Act which had been taken *in toto* from the Model Business Corporation Act. Section 35 of the Model Act, and the now defunct Section 3 of the Illinois Act[8] are identical. In deciding that Section 3 was unconstitutional, the Illinois Court drew attention to the fact that this section of the Model Act needs much study and revision before it can serve as a pattern for the many states currently considering revision of their corporate statutes. Still the Act is being adopted, in whole or in part, with only insignificant modifications in those states which are now awakening to the need for a more flexible and well-defined statute.

The Illinois case illustrates the endless litigation which may occur in other states adopting the Model Act. Of the thirty-seven states which have a specific provision on the subject of cumulative voting, thirteen have constitutional provisions making it mandatory, seven have statutory provisions making it mandatory and seventeen states have statutory provisions allowing cumulative voting.[9] In general the trend is toward rather than away from cumulative voting.

The minority stockholder is well represented in the tentatively proposed Federal Charter Compliance Statute of Senator Joseph C. O'Mahoney, which is to be introduced in the 85th Congress. Section 4 (b) of that Act provides for cumula-

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[6] *Id.* at 14 (proxy statements of ten leading corporations).

[7] Circuit Court of Cook County, No. 54 C 15200 (Feb. 1, 1955), affirmed by Illinois Supreme Court, Chicago Daily News, April 15, 1955.

[8] ILLINOIS REV. STAT. c. 32, § 157.35 (1953).

[9] Campbell, *The Origin and Growth of Cumulative Voting for Directors*, 10 The Business Lawyer 3 (1955).

tive voting. Obviously, if a specific provision can be found in any state statute allowing for cumulative voting it was not designed to be circumvented by a subsequent provision for a classification of directors. Yet, on its face the classification section would seem to thwart the cumulative voting privileges of minority stockholders when the board of directors of a corporation is composed of nine or more members. To put an end to this denial of minority stockholders rights, the most effective remedy can be had by national legislation. The Federal Charter Compliance statute of Senator O'Mahoney seeks to remedy certain evils of corporate charters by instituting certificates of compliance to be awarded to corporations which include the specific provisions spelled out so comprehensively in the Act. The Federal Act attempts to solve the cumulative voting problem. Section 4 (b) of the Act (the cumulative voting section) is immediately followed by Section 4 (c) (1) which provides that all members of the board of directors be elected annually. This would make the classification provision null and void at its inception and maintain the correct status of cumulative voting.

Certainly the Model Business Corporation Act does not fail in every respect; but it does present problems, originating as far back as 1928,[10] which some state legislatures, currently considering the adoption of the whole Act or part of it, may be glancing over.

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[10] 53 A.B.A. REP. 89-92.