

July 1956

## Corporations—Cumulative Voting—Staggered Elections and Classification of Directors

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### Recommended Citation

Douglas P. Beighle, *Corporations—Cumulative Voting—Staggered Elections and Classification of Directors*, 18 Mont. L. Rev. 107 (1956).

Available at: <https://scholarworks.umt.edu/mlr/vol18/iss1/4>

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. . . to the waiver of the requirement of a bond for costs if such waiver is necessary to the presentation of his appeal.'<sup>18</sup>

This decision will have the general effect of tending to eliminate any instances where a defendant convicted of a crime is prevented from appealing to the appellate court of his state solely on the ground that he is not financially able to purchase a transcript of the trial record, put up security for an appellate bond, or pass any other financial hurdle erected by the laws of his state. This result is desirable<sup>19</sup> and the case will undoubtedly hasten the time when all of the states will have a simple, efficient system of allowing an indigent full appellate review of his conviction in a criminal court, where there is merit in his appeal.<sup>20</sup> If the Court really meant that this was an equal protection question, as well as a due process question, both concepts of constitutional guarantees were extended into the new area of economic inequality, where the possibilities of application are virtually unlimited.

GEORGE DALTHORP

CORPORATIONS—CUMULATIVE VOTING—STAGGERED ELECTIONS AND CLASSIFICATION OF DIRECTORS—Louis Wolfson, a minority owner of common stock of Montgomery Ward and Co., and in the midst of a proxy fight with the management for the control of the board of directors, had protested to the defendant, Sewell Avery, that the by-law of Montgomery Ward which authorized the election of only one-third of the company's nine directors each year was illegal. Subsequently he brought action seeking a declaratory judgment to the effect that a provision of the Illinois Constitution<sup>1</sup> guaranteeing the right to vote cumulatively in the election of corporate directors was violated by the Illinois Business Corporation Act, section 35,<sup>2</sup> and the

<sup>18</sup>The court is probably right. "Surely no one would contend that either a state or the Federal Government could constitutionally provide that defendants unable to pay court costs in advance should be denied the right . . . to defend themselves in court. . . . There is no meaningful distinction between a rule which would deny the poor the right to defend themselves in a trial court and one which effectively denies the poor an adequate appellate review accorded to all who have money enough to pay the costs in advance." Instant case at 17.

<sup>19</sup>The following are possible objections to the decision: (1) *The decision is an example of federal meddling in state affairs.* But the states are not free to deprive their citizens of rights guaranteed by the Federal Constitution. (2) *It will impose great expense on the states.* Since a majority of the states do make provisions for furnishing indigents with transcripts, the others should be able to, also. In addition there may be other ways in which a state may allow an indigent to appeal which are less expensive. (3) *It may result in the states' limiting the right to appeal.* This seems unlikely since society has come to consider appeals as essentially a right. (4) *Prisoners now in confinement will ask for free transcripts so they may appeal also.* Practically forbids the states' allowing this. One rationalization is that the prisoners waived their right to a free transcript by not making a timely request. Perhaps a more realistic one is that the decision is effective only for the future and is not retroactive, being in fact a new rule rather than a discovery of what has always been the law.

<sup>20</sup>The majority opinion states that the petitioners had alleged that there were errors in the trial which entitled them to have their convictions set aside on appeal and that these allegations were not denied. Therefore, it was assumed that there was merit in the appeal in the instant case. It is a reasonable conclusion that this decision may apply only where there is apparently merit in an appeal.

<sup>1</sup>ILL. CONST. art. XI, § 3.

<sup>2</sup>ILL. ANN. STAT. c. 32, § 157.35 (1954).

company's by-law enacted pursuant thereto, which authorized the division of corporate boards of nine or more directors into two or three classes for the purpose of elections, and the election of only one class annually. The lower court granted the plaintiff's motion for judgment on the pleadings, and declared section 35 and the by-law of the company in conflict with a constitutional provision and therefore invalid. On appeal to the Supreme Court of Illinois, held, affirmed. The practice of classification and staggered elections is unconstitutional because it directly infringes upon the right of cumulative voting granted by the Illinois Constitution and denies representation proportionate to stock ownership. *Wolfson v. Avery*, 6 Ill. 2d 78, 126 N.E.2d 701 (1955) (Justice Hershey dissenting).

Historically, the right to vote is an incident of stock ownership and is a valuable right, affording the stockholder a voice in the management of the corporation. Under the common law each stockholder was limited to one vote regardless of the number of shares that he owned. Subsequently, however, statutes were enacted giving stockholders a more equitable representation by allowing them one vote for each share of stock that was held. These statutes were designed to eliminate the unfairness brought about by allowing a party with one share of stock the same voting power as someone holding 1000 shares. Since the system allowed one vote per director for each share of stock that was owned, those who controlled 51 per cent of the outstanding stock were able to elect the entire board of directors, while the minority, possessing some 49 per cent of the stock were not represented at all.

Then about the middle of the nineteenth century, there arose a second theory of corporate control, that of minority representation and minority rights. The proponents of this school of thought asserted that the minority had a right to representation on the board of directors in order to provide a method of checking on the actions of the majority in control. This theory arose shortly after the Civil War, largely as a result of public indignation over the current business scandals, excesses and frauds perpetrated by corporate management. Publisher Joseph Medill of the *Chicago Tribune* was running a continual attack upon the management of corporations. In one such editorial he pointed out that if the four-ninths of the stock of the Erie Railroad which was held by opponents of Fisk and Gould had been allowed any representation at all, quite possibly the Erie scandal could have been prevented. So, as the delegates gathered for the Illinois constitutional convention, one of the chief topics of discussion was how to curb the power of the rings that ran the corporations and had mulcted thousands of small investors. In 1870 the reformation forces, led by that strong delegate, publisher Medill, succeeded in having the convention adopt the principle of cumulative voting, and so it was in the Illinois Constitution that the principle of cumulative voting was first ushered into the field of American law. The constitutional provision was adopted almost verbatim from the draft proposed by Medill, and it provided that a stockholder is entitled to as many votes as he has shares of stock, multiplied by the number of directors who are to be elected. He may concentrate all of his votes on one candidate, or distribute them among as many candidates as he sees fit. Under this sys-

tem of voting, holders of 49 per cent of the voting stock can elect four of a board of nine directors.<sup>3</sup>

Following the lead of Illinois, cumulative voting in corporate elections has been made mandatory by constitutional provisions in twelve other states,<sup>4</sup> and by statute in seven more.<sup>5</sup> In addition, twenty states<sup>6</sup> have statutes authorizing *permissive* cumulative voting.<sup>7</sup> Of the thirteen states that have mandatory cumulative voting by constitutional provision, seven of them permit by statute the dividing of the board of directors into classes, and the election of only one or more classes each year.<sup>8</sup> Of the seven that have mandatory cumulative voting by statute, five allow classification and staggered elections.<sup>9</sup> All twenty of the states which provide for permissive cumulative voting authorize the classified boards and staggered elections.<sup>10</sup>

Although other states<sup>11</sup> have constitutional provisions and statutes sufficiently similar to raise the same problem, the only system of classification previously questioned was a division of a board of directors into classes consisting of one director in each class, with the election of only one class annually. The California court in *Wright v. Central California Colony Water Co.*<sup>12</sup> decided that this single election of a single director completely circumvented the principle of cumulative voting, as you can have no cumulative voting if only one director is to be elected. The Ohio appellate court upheld this principle in *Humphrys v. Winous*;<sup>13</sup> however, the decision of the appellate court was later reversed by the Ohio Supreme Court,<sup>14</sup> which held that the statute granting the right of cumulative voting conferred only that right, and did not undertake to guarantee minority representation.

The *Wolfson* case appears to be the first reported decision in which the entire principle of classification and staggered elections was challenged. For 83 years the question had not arisen in Illinois, and, except for the California and Ohio decisions, had received scant judicial attention elsewhere. The provision of the Illinois Constitution over which the *Wolfson* case arose was the statement that "every stockholder shall have the right to vote . . . for as many persons as there are directors or managers *to be elected*,

<sup>3</sup>See Stephan, *Cumulative Voting and Classified Boards: Some Reflections on Wolfson v. Avery*, 31 NOTRE DAME LAW. 351 (1956), for an extensive discussion of the history prior to the *Wolfson* decision, and an analysis of the pros and cons of cumulative voting and classified boards. Mr. Stephan was the attorney for plaintiff Wolfson.

<sup>4</sup>Ariz., Idaho, Ky., Miss., Mo., Mont., Neb., N.D., Pa., S.C., S.D., W.Va.

<sup>5</sup>Ark., Cal., Kan., Mich., Ohio, Wash., Wyo.

<sup>6</sup>Colo., Del., Fla., Ind., La., Md., Minn., Nev. N.H., N.J., N.M., N.Y., N.C., Okla., Ore., R.I., Tenn., Tex., Vt., Va.

<sup>7</sup>In the absence of such express provision, a stockholder has no right to vote cumulatively. *In re American Fibre Chair Seat Corp.*, 265 N.Y. 416, 193 N.E. 253, 43 A.L.R.2d 1342 (1934); *State ex rel. Baumgardner v. Stockley*, 45 Ohio St. 304, 13 N.E. 279, (1887); *State ex rel. Swanson v. Perham*, 30 Wash. 2d 368, 191 P.2d 689, (1948).

<sup>8</sup>Ky., Mo., Mont., N.D., Pa., W.Va.; Illinois did prior to the *Wolfson* case.

<sup>9</sup>Ark., Kan., Mich., Ohio, Wash.

<sup>10</sup>See note 6 *supra*.

<sup>11</sup>Montana, Nebraska and West Virginia have similar constitutional provisions and classification statutes.

<sup>12</sup>67 Cal. 532, 8 Pac. 70 (1885).

<sup>13</sup>125 N.E.2d 204 (Ohio App. 1955)

<sup>14</sup>*Humphrys v. Winous*, 165 Ohio St. 45, 133 N.E.2d 780 (1956).

or to cumulate . . . [his] shares, and give one candidate as many votes as the number of directors multiplied by the number of shares.'"<sup>15</sup> There is no doubt that the language of the section is ambiguous.<sup>16</sup> The Illinois court, after considerable discussion, concluded that the words "to be elected" did not qualify the words "number of directors" and thus reached its decision. However, the court in reaching its decision was not simply making an interpretation of the language of the Illinois Constitution, but was faced with the question whether the drafters of the constitution desired that the minority stockholders should have proportional representation or just some representation. The court in answering this question asked themselves: Was it probable that the constitutional convention, after providing for the right of cumulative voting, intended to subject it to the limitations and restrictions of classification and staggered elections? To this question they answered, no.<sup>17</sup>

Just what effect does the practice of allowing classification and staggered elections have on the right of cumulative voting? Assume that, for example, you have a corporation with a nine man board of directors, elected annually. It would take ten per cent of the stock plus one share to elect one director voting cumulatively.<sup>18</sup> However, if the board is classified into equal groups of three, each group having a three year term, and each group elected on a different year, then it would take 25 per cent of the stock plus one share to elect one director. Thus, it can be seen that where, as in the example above, you allow classification of directors and staggered elections, it would take 150 per cent more stock for a minority stockholder to elect one director than if all nine directors were elected simultaneously.

<sup>15</sup>ILL. CONST. art. XI, § 3 (emphasis added).

<sup>16</sup>Ballantine, *A Critical Survey of the Illinois Business Corporations Act*, 1 U. CHI. L. REV. 357, 385 (1934). Ballantine, in reviewing this provision, placed a question mark after the words "to be elected," indicating that he was unsure of their meaning.

<sup>17</sup>The tendency of the Illinois court has been to construe strictly Article XI, § 3 of their constitution which reads as follows: "The general assembly shall provide, by law, that in all elections for directors or managers of incorporated companies, every stockholder shall have the right to vote, in person or by proxy, for the number of shares of stock owned by him, for as many persons as there are directors or managers to be elected, or to cumulate said shares, and give one candidate as many votes as the number of directors multiplied by the number of his shares of stock shall equal, or to distribute them on the same principle among as many candidates as he shall think fit; and such directors or managers shall not be elected in any other manner." The Illinois court had previously decided in *People v. Emmerson*, 302 Ill. 300, 134 N.E. 707 (1922), that this section prohibited the issuance of non-voting stock. And in *People v. Cohn*, 339 Ill. 121, 171 N.E. 159 (1930), the court had decided that the language of the section precluded the board of directors from appointing a new director to the board to serve out an unexpired term of a deceased or resigned director, and said that the vacancy must be filled by an election by the stockholders. While the above two limitations were clearly not part of the express language of the provision and were read into the section by the court, there is no doubt but that the language did expressly deal with the question of cumulative voting, and that the court was on much firmer ground in the *Wolfson* case than in the previous ones. It is easily discernible that the court's interpretation of the language of the section in the *Wolfson* case was merely another step in line with this tendency.

<sup>18</sup>The formula for computing the amount of stock needed to elect each director by cumulative voting is as follows: (X=shares needed to elect a single director,

$$X \text{ equals } \frac{Y}{N \text{ plus } 1} \text{ plus 1 share} \quad \begin{array}{l} Y = \text{total of shares voting,} \\ N = \text{number of directors to be elected).} \end{array}$$

WILLIAMS, CUMULATIVE VOTING FOR DIRECTORS 41 (1951).

The dissent in the *Wolfson* case points out several arguments for the theory of coexistence of cumulative voting and staggered elections and classification. It states that the idea, that cumulative voting and staggered elections and classification cannot both be given effect, could only be true if staggering and cumulating were contradictory or mutually exclusive. But, it contends, they are not inconsistent or incompatible, as both may clearly exist at the same time, since at some percentages more directors can be elected by the minority stockholders at staggered elections than by electing them all at once.<sup>19</sup> Thus, the dissent contends, cumulative voting and classification and staggered elections can coexist, and together they bring about continuity of company policies and assure that there will always be experienced directors on the board. It cites, as further evidence, that cumulative voting, staggered elections, and a classified board are recommended in the *Model Business Corporation Act*;<sup>20</sup> that in various federally chartered associations they are made mandatory; and that the practice is allowed in 32 other states.<sup>21</sup>

The *Wolfson* decision has a special interest in Montana. The Montana constitutional provision on cumulative voting<sup>22</sup> is almost verbatim that of Illinois. Montana also has a statute providing for classification of directors and their election to different terms.<sup>23</sup> However, while the Montana constitutional provision is almost identical with that of Illinois, the statute on classification and staggered terms differs considerably.<sup>24</sup> The Montana statute, in part, provides for "the several classes to be elected for different terms."<sup>25</sup> This phrase is very ambiguous in that it is impossible to ascertain whether the legislature meant that each class shall have terms of different lengths, or that just the first class elected after the corporation begins using a classified board shall have terms of a different length. Montana also has a statute providing that the size of the board will be "not less than three nor more than thirteen directors."<sup>26</sup> Therefore, in Montana it is possible (and may even exist), that a three man board of directors could be divided into three classes of one director each, and each class could be elected separately. Clearly this would be in direct violation of the Montana constitutional provision of cumulative voting, for you can have no cumulative voting if only one director is to be elected.<sup>27</sup>

Just what effect should the *Wolfson* decision have on Montana and on other jurisdictions? In those states where both cumulative voting<sup>28</sup> and classification of directors<sup>29</sup> were made possible by the legislature, the *Wolf-*

<sup>19</sup>One example is 30% of the voting stock held by minority stockholders. If there is a nine man board elected all at one time, then by voting cumulatively you could elect two directors. However, if the board is divided into three classes of three directors each, and one class elected each time, then you could elect one each time for a total of three.

<sup>20</sup>UNIFORM LAWS ANN. 52.

<sup>21</sup>See notes 6, 8, and 9 *supra*.

<sup>22</sup>MONT. CONST. art. XV, § 4.

<sup>23</sup>REVISED CODES OF MONTANA, 1947, § 15-402. Also mentioned in R.C.M. 1947, § 15-403.

<sup>24</sup>R.C.M. 1947, § 15-402.

<sup>25</sup>*Ibid.*

<sup>26</sup>R.C.M. 1947, § 15-401.

<sup>27</sup>See Note 5 *supra*.

<sup>28</sup>See note 9 *supra*.

<sup>29</sup>See notes 4 and 8 *supra*.

son decision should not have a controlling effect. For that which the legislature gives, the legislature can take away or modify, and the problem becomes simply one of statutory interpretation. However, a substantially different and much more difficult question arises in those states, as in Montana, where the right to vote cumulatively has been conferred by constitutional provision.<sup>80</sup> In Illinois, the constitutional provision was adopted as a result of public indignation over the excesses of corporate directors, and the court in the *Wolfson* case based its opinion, in large part, on the fact that cumulative voting was adopted in Illinois as an expression of strong public policy. The courts of the states with similar constitutional provisions, if and when the question arises, will have to probe into and examine the history behind the adoption of their constitutional provisions, and if they find, as the Illinois court did, that their provision arose as a result of strong public policy and was designed to guarantee minority representation on corporate boards, the *Wolfson* decision should become controlling. If, on the other hand, the courts find that the provision was adopted merely with the idea of providing the right to vote cumulatively, then they would be justified in either following or disregarding the *Wolfson* decision.

It is difficult to determine what stand the Montana Supreme Court would take in deciding the question posed by the *Wolfson* case. Its decision would involve two factors: First, a determination of the public policy the constitutional convention intended to embody in the constitutional provision; and second, a consideration of the relative merits of the two theories. It is doubtful that history will reveal the intent of the constitutional convention.<sup>81</sup> Therefore the decision would probably be based upon the merits of the two theories, coupled, of course, with whatever evidence may be available of the intent of the convention.

DOUGLAS P. BEIGHLE

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INCOME TAX—CHARITABLE DEDUCTIONS—PROPAGANDA AND INFLUENCING LEGISLATION—During the years 1946 to 1949, petitioners had deducted severally and jointly in their Federal Income Tax returns contributions made in those years to the Hamilton County Good Government League, incorporated as a non-profit corporation to provide an opportunity for discussion of matters of civic importance and to advance good government. It had neither contributed to, nor affiliated with any political party, but had urged its members to vote and to support legislation that was for the public good. In addition, committee members of the League were *personally* responsible for making studies of necessary legislation to effect public purposes, and for making endorsements of political candidates to the League, but these activities involved no expenditure of League funds. Less than five per cent of the time and effort of the League was found to be of a political nature. The Tax Court disallowed deductions to the League under

<sup>80</sup>Wright v. Central Calif. Colony Water Co., 67 Cal. 532, 8 Pac. 70 (1885).

<sup>81</sup>For an interesting discussion of the possible intent of the Montana Constitutional Convention when they adopted this provision, and dealing specifically with the question of non-voting stock in Montana, see Note, 1 MONTANA L. REV. 60 (1940).