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Corporate By-Law Dispensing with Cumulative Voting Held Void as a By-Law and Unenforceable as a Contract

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RECENT DECISIONS

CORPORATE BY-LAW DISPENSING WITH CUMULATIVE VOTING HELD VOID AS A BY-LAW AND UNENFORCEABLE AS A CONTRACT.—Plaintiff, while president of the defendant corporation, appointed a committee at a regular board of directors meeting to draft an amendment to the by-laws which would abrogate the right of the stockholders to vote cumulatively. This amendment was unanimously accepted at a subsequent stockholders meeting. Two years later, after the plaintiff had been succeeded as president, he was denied, pursuant to the amended by-law, the right as a stockholder to vote cumulatively in a regular election of officers. Plaintiff prevailed in an action in the district court to have the election declared null and void. On appeal by the corporation to the Montana Supreme Court, *held*, affirmed. A corporation may not deprive a stockholder of the right of cumulative voting by any act on its part, nor is a corporate by-law which attempts to do so enforceable as a contract between parties assenting to it. *Sensabaugh v. Polson Plywood Co.*, 135 Mont. 562, 342 P.2d 1064 (1959) (Justice Adair concurring in the result; Justices Angstman and Bottomly concurring in part and dissenting in part).

This case, as presented on appeal, reduced itself to three issues: first, whether a corporation may, by means of a by-law, deny the right of cumulative voting; second, whether a stockholders' contract to refrain from cumulative voting is against public policy and void; and third, whether a stockholders' contract may take the form of a by-law and be binding on those parties assenting to it.

As to the first issue, all the justices were in accord. The proposition is well settled that a corporation may not deprive a stockholder of the right of cumlative voting by any act on its part when such right is guaranteed by express constitutional provision.[1] The Montana constitution provides:[2]

> The legislative assembly shall provide by law that in all elections for directors or trustees of incorporated companies, every stockholder shall have the right to vote [cumulatively] . . . *and such directors and trustees shall not be elected in any other manner.* (Emphasis supplied)

The court could not agree on the second issue. In the majority opinion Justices Harrison and Castles took the position that a contract to refrain from cumulative voting is not against public policy. To support their contention they cited a Nebraska case[3] in which the court construed a similar constitutional provision, also containing the prohibitory clause, "shall not

[1]See 5 FLETCHER, CYCLOPEDIA CORPORATIONS § 2025 (perm. ed. rev. repl. 1952), and cases cited therein.
[2]Art. XV, § 4. REVISED CODES OF MONTANA, 1947, § 15-405 provides for substantially the same thing except the prohibitory clause is omitted.
[3]E. K. Buck Retail Stores v. Harkert, 157 Neb. 867, 62 N.W.2d 288, 45 A.L.R.2d 774 (1954).

Montana Law Review, Vol. 22 [1960], Iss. 2, Art. 6

be elected in any other manner." The Nebraska court in turn adopted the reasoning of a Missouri case which held, with respect to a like provision:[4]

> A construction has nowhere been given to section 6, art. 12, within our knowledge or research, so as to constitute it a prohibition or restriction on the right of stockholders to make their contracts which violate no rule of the common law, and which affect no rights except their own.

The Nebraska court further stated that the prohibitory clause in the Nebraska constitution did no more than make it mandatory that every *corporation* within the purview of the constitutional provision shall permit cumulative voting. The instant case adopted the reasoning of this Nebraska case and apparently construed article XV, section 4 of the Montana Constitution to impose a limitation only upon the corporation itself so that the minority stockholders' right of representation in the corporation's business may be secured against corporate action.

Although the majority recognized that the stockholders may contract away their right of cumulative voting, Justices Harrison and Castles were unwilling to construe the invalid by-law as a contract binding on those parties assenting to it. They stated:[5]

> It must . . . be remembered . . . that the matter of initiating the move to dispense with cumulative voting did not arise among the stockholders as such in the first instance. . . . [T]he entire matter was handled within the corporate structure from its inception to its conclusion. To enforce this by-law, invalid as a by-law, as a contract will amount to a deprivation of the right . . . of a minority of stockholders to secure a greater representation in the management of the corporate business through the exercise of cumulative voting.

It seems unrealistic to deny enforcement of this agreement on the ground that the matter was initiated by the directors and did not raise in the first instance among the stockholders, as such. The directors themselves were very substantial stockholders. The by-law amendment was not passed by a vote of the directors who drafted it, for directors as such have no vote in matters concerning amendment of by-laws or election of officers.[6] Rather, it was the vote of the directors and others in their capacity as *stockholders* that caused this amendment to be passed. This group, with full knowledge of all the material facts, mutually assented by recorded vote in a duly called stockholders' meeting to refrain from cumulative voting. If the stockholders' right to vote cumlatively may be waived by private contract, as admitted by the majority, then enforcing such an agreement between those who assented to it is no denial of constitutional rights.

Even though the initiation of the by-law by the directors may not itself be sufficient reason to nullify the by-law as a contract among the assenting stockholders, a question remains whether the by-law should still be held not

[4]State *ex rel.* Frank v. Swanger, 190 Mo. 561, 89 S.W. 872, 2 L.R.A. (n.s.) 121 (1905).
[5]Instant case at 568, 342 P.2d at 1068.
[6]Revised Codes of Montana, 1947, §§ 15-301, -403 to -405.

binding as a contract on the ground that the assenting stockholders did not receive what they bargained for, *i.e.*, the benefit of having all of the stockholders equally bound. In all probability their intent was to be bound by the limitation on cumulative voting only if all the stockholders, both assenting and nonassenting, were bound. And even if it is concluded that the stockholders should be bound only upon receiving what they bargained for, it may be sufficient to satisfy this requirement that they received substantially what they bargained for, which might well be true if the nonassenting stockholders had only minor or nominal interest in the corporation. Further, if others should act in reliance on the invalid by-law, the issue of estoppel is raised, to be determined according to the varying facts of such case. These are but a few of the many facets of the problem of determining whether an invalid by-law can serve as a contract.

Although stockholders' agreements have been the subject of much litigation in other jurisdictions, there has been none in Montana. A majority of jurisdictions deciding the question of the validity of stockholders' contracts have taken the position that stockholders may enter into contracts to vote their shares in a certain manner when it appears that the following conditions are met: first, that such agreement is for the good of the corporation; second, that it does not contemplate fraud upon other stockholders or creditors; and third, that it is not against public policy.[7] Neither the majority opinion nor Justice Angstman contended that there were facts present which would void the agreement on the above grounds.

Justice Angstman took the position that although this by-law would not be binding upon dissenting stockholders, it should be binding as a contract on those who assented to it since there is no rule of law which prescribes any particular form that such a contract must take. It has been recognized in other jurisdictions that a by-law, if not opposed to public policy, may be enforced as a contract and be binding on those who assent to it, even though it is invalid as a by-law.[8]

After an analysis of article XV, section 4 of the Montana Constitution and certain sections of the Montana codes,[9] Justice Bottomly, relying on a Colorado case,[10] stated flatly that any attempt by either the corporation or its stockholders to vary the method of voting set out in the constitution is against the public policy of this state and hence void.[11]

In the case relied on, *People v. Burke*, the contract sought to be enforced was between a storage company and the stockholders of a canal company. The contract was particularly offensive since it provided that a rival

[7]See, *e.g.*, Smith v. San Francisco & N.P. Ry., 115 Cal. 584, 47 Pac. 582, 35 L.R.A. 309 (1897); Winsor v. Commonwealth Coal Co., 63 Wash. 62, 114 Pac. 908, 33 L.R.A. (n.s.) 63 (1911); for further discussion on stockholders' agreements see generally 5 FLETCHER, CYCLOPEDIA CORPORATIONS § 2064 (perm. ed. rev. repl. 1952), and 13 AM. JUR. *Corporations* § 500 (1938) and cases cited therein.

[8]Oakland Scavenger Co. v. Gandi, 51 Cal. App. 2d 69, 124 P.2d 143 (1942); Sterling Loan & Investment Co. v. Litel, 75 Colo. 34, 223 Pac. 753 (1924); see also 18 C.J.S. *Corporations* § 181(b) (1939) and cases cited therein.

[9]REVISED CODES OF MONTANA, 1947, §§ 12-101, -102, -104, and 83-101.

[10]People *ex rel.* Arkansas Valley Sugar Beet & Irrigated Land Co. v. Burke, 72 Colo. 486, 212 Pac. 837, 30 A.L.R. 1085 (1923).

[11]Instant case at 569, 342 P.2d at 1068.

corporation, whether it owned stock or not, could control the election of one of the directors of the defendant canal corporation for an indefinite time. Justice Bottomly, in writing his dissent, extracted several statements made by the court in the *Burke* case which, when taken out of context, appear to support the view adopted by him. The Colorado court did not decide the contract to be void *per se* solely on the ground that it violated the prohibitory clause, "and shall not be elected in any other manner," contained in their governing statute.[12] Rather, it took great care to point out the true objections it had to the particular contract in question. The following is indicative of the actual basis of their holding:[13]

> Specifically it is void upon its face, because it purports to confer upon the storage company, which has no beneficial ownership in the stock, and which has given to the stockholders no consideration therefor, the irrevocable power for all time to vote the stock, not in the interests of the canal company, but in its own interests, which are antagonistic and adverse to the interest of the canal company. It is also void upon its face, because it purports to give to the minority stockholders the power, for all time, to control the affairs of the canal company. The purpose for which the contract was made, thus to perpetuate control, is unlawful in that it is unfair to the stockholders of the company and in favor of a rival corporation which may not own any stock of the canal company itself, and, if it is a stockholder, the contract discriminates against all other stockholders. *Such being our conclusion, it is unnecessary to determine whether all separations of voting power from beneficial ownership, all irrevocable powers of attorney for the voting of stock, or all voting trust agreements are invalid.* (Emphasis supplied)

Thus it is readily apparent that the *Burke* case is distinguishable from the instant case. The contract in the *Burke* case and the one sought to be enforced in the instant case were entirely dissimilar and were for different purposes. The agreement in the instant case was between stockholders, not between stockholders and a different corporation; it did not have the effect of separating the voting privileges from the beneficial interest; it was not an unlimited burden upon all the stockholders, but rather a personal obligation upon those assenting to it; it did not forfeit the stockholders' rights to vote for some or all of its directors, but rather limited those who assented to one of two constitutional methods. The agreement sought to be enforced in the instant case in no way affects the rights of those stockholders who did not assent to the contract. It is submitted that the *Burke* case is not authority for holding stockholders' contracts void per se, and further it not authority in Montana for the proposition that our constitutional prohibitory clause, "and shall not be elected in any other manner," is declarative of public policy in this state in regard not only to corporate acts but also to acts of the individual stockholders.

It appears that the Supreme Court of Montana has decided that stockholders' contracts restricting their voting rights are not against public policy and may be valid. Whether these contracts must assume a particular

[12] Colo. R.S. 1908, § 865.
[13] 212 Pac. at 843.

form is not so clear. Two of the three members of the court speaking on this issue would apparently require that such contracts, to be enforceable, cannot be expressed in the form of corporate by-laws.

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CONSTITUTIONALITY OF STATUTE DELAYING COMMENCEMENT OF ADVERSE POSSESSION BY TENANT AGAINST LANDLORD IS QUESTIONED BY COURT—In 1931 property which defendant claimed to own was sold for delinquent taxes. In 1933 defendant leased the premises to plaintiff, the lease providing that it should terminate if the lessor were unable to pay the taxes or should lose possession. The lessor failed to pay the taxes and in 1936 plaintiff, who had continued in possession, entered into a contract to purchase the property from the county, subsequently receiving a deed which in 1941 was held invalid.[1] In 1955 plaintiff commenced an action to quiet title to the property in himself on the basis of adverse possession. The district court concluded that adverse possession had been established. On appeal to the Montana Supreme Court, *held,* affirmed. A lease stating that taxes are then delinquent and providing that if the landlord shall be unable to pay them the lease shall be automatically terminated constitutes a waiver of the benefit of the statute which requires that a tenant maintain adverse possession against his landlord for twice the ordinary period.[2] *Johnstone v. Sanborn,* 358 P.2d 399 (Mont. 1960) (Justice Adair dissenting).

At the time of this adverse possession Revised Codes of Montana, 1947, section 93-2512 provided:

> When the relation of landlord and tenant has existed between any persons, the possession of the tenant is deemed the possession of the landlord until the expiration of ten years from the termination of the tenancy, or, where there has been no written lease, until the expiration of ten years from the time of the last payment of rent, notwithstanding such tenant may have acquired another title, or may have claimed to hold adversely to his landlord. But such presumptions cannot be made after the periods prescribed in this section.

The following section required adverse possession for ten years for perfecting of title.[3] In 1953 both provisions were amended to make the periods five years. The effect of the two sections is to provide for a doubly long period of adverse possession where a landlord-tenant relationship has existed and the tenant has not relinquished possession between his tenancy and his adverse possession.

Since it held that the lessor had waived the benefit of the statute, the court was not obliged to apply it, but the majority opinion went out of its way to state[4]:

[1]Sanborn v. Lewis and Clark County, 113 Mont. 1, 120 P.2d 567 (1941).
[2]The court also held in the alternative that on the basis of prior proceedings the title should be quieted in the plaintiff.
[3]REVISED CODES OF MONTANA, 1947, § 93-2513.
[4]Instant case at 400.