# California Law Review

Published Quarterly throughout the Year by Students of the School of Jurisprudence of the University of California, Berkeley, California. Indexed in Index to Legal Periodicals, Public Affairs Information Service and in Current Legal Thought.

Subscription Price, $4.50 Current Single Copies, $1.25



# Comment

## CORPORATIONS: VOTING TRUSTS AND IRREVOCABLE PROXIES

Among the various control devices which have been employed to separate voting power from the ownership of corporate shares, perhaps the most common are the voting trust and voting agreement.[1] Because of certain practical difficulties, however, the development of the voting agreement has been largely overshadowed by the parallel growth of the voting trust. These problems have arisen because of the structure of a voting agreement, under which legal title remains in the individual shareholder[2] so that any delegation of the right to vote his shares cannot be considered otherwise than as a proxy, re-

[1] BALLANTINE, CORPORATIONS (Rev. ed. 1946) § 182.

[2] The usual definition of a voting agreement is a contract among two or more shareholders whereby they retain not only the legal and beneficial ownership of their shares, but also their individual right to vote them, and merely agree to vote all their combined stock as a unit in a predetermined manner. Note (1936) 3 U. OF. CHI. L. REV. 640, 641.

vocable, under the present-day view, unless coupled with an interest.[3]

This situation recently faced the Delaware court in *Ringling Bros.-Barnum & Bailey Com. Shows v. Ringling*.[4] Of the three shareholders holding all of the outstanding stock, two had agreed to vote their shares as a unit in a manner to be determined by agreement, or, if no agreement could be reached, in the manner determined by a named arbitrator. Following a disagreement, one of the parties refused to follow the direction of the arbitrator and voted his shares independently at an election of directors. In an action to have the election set aside, the chancellor decreed that a new election be held, at which the shares were to be voted in accordance with the direction of the arbitrator.[5] The Delaware supreme court reversed the decree of specific performance but directed that the votes cast in violation of the agreement be rejected in determining the result of the election. The court's reason for denying specific performance is not entirely clear,[6] but to this extent the holding is in line with prior decisions and dicta which have advanced the doctrine that voting agreements will not be specifically enforced.[7]

There are conceivably three paths which a court may take when faced with this situation, none of which seems very satisfactory. It may grant specific performance; it may refuse to give any relief other than damages; or, as was done by the Delaware court, it may deny complete specific performance but nullify any votes cast contrary to the agreement. No decision has been found which affirmatively decreed that a new election be held, at which a voting agreement was to be specifically performed. On the other hand, there are several decisions which have denied specific performance.[8] The result has usually been placed on the ground that specific performance is not feasible because of the continuous supervision required,[9] but this

[3] Babcock v. Chicago Rys. Co. (1927) 325 Ill. 16, 155 N.E. 773; State v. Pacific Waxed Paper Co. (1945) 22 Wash. (2d) 844, 157 P. (2d) 707; Axe, *Corporate Proxies* (1942) 41 MICH. L. REV. 225, 256; Note (1945) 159 A.L.R. 307.

[4] (Del. May 3, 1947) 53 A. (2d) 441.

[5] Ringling v. Ringling Bros.-Barnum & Bailey Comb. Shows (Del. Ch. 1946) 49 A. (2d) 603.

[6] There is some indication in the language of the opinion that if the agreement had provided for a power in each party to exercise the voting rights of the other, the court might have granted specific performance. See Comment (1947) 46 MICH. L. REV. 70, 74.

[7] Rosenkrantz v. Chattahoochee Brick Co. (1918) 147 Ga. 730, 95 S.E. 225; see Haldeman v. Haldeman (1917) 176 Ky. 635, 651, 197 S.W. 376, 383; Gage v. Fisher (1895) 5 N.D. 297, 303, 65 N.W. 809, 811; Gleason v. Earles (1914) 78 Wash. 491, 504, 139 Pac. 213, 218; 5 FLETCHER, CYC. CORPS. (Perm. ed. 1931) § 2067. The doctrine appears to have sprung originally from dictum in Gage v. Fisher, *supra*, and most of the decisions which have repeated it have involved voting agreements which were otherwise objectionable. See Note (1947) 96 U. OF PA. L. REV. 121.

[8] Cases collected in note 7, *supra*.

[9] Rosenkrantz v. Chattahoochee Brick Co. (1918) 147 Ga. 730, 95 S.E. 225; Haldeman v. Haldeman (1917) 176 Ky. 635, 651, 197 S.W. 376, 383.

reasoning is far from convincing. A more compelling factor would seem to be a natural reluctance to interfere with a consummated election because of violation of an agreement to which the corporation and other shareholders are not parties. On the other hand, since the object of the contract is to gain control, it would appear that damages would be of so speculative a nature that the agreement could have no practical significance except in terms of specific enforceability.[10]

In spite of the shortcomings of either specific performance or damages, the novel solution reached by the Delaware court can hardly be commended. Such a decision, although not likely to be forced upon the innocent party, might conceivably produce a result which does even greater violence to the intention of the parties than a holding that the agreement is of no legal effect whatever.[11]

The only satisfactory solution to this problem is some arrangement by which voting agreements are rendered self-executing. At present, the law affords only one device by which this may be accomplished—the voting trust.[12] A voting trust is created by a transfer of pooled shares to a trustee or trustees for the purpose of controlling their voting power, thus by its very nature avoiding the difficulty encountered in the *Ringling* case.[13] However, recognition of the voting trust as a valid device for achieving a binding separation of voting power from the beneficial ownership of corporate shares has raised a new set of problems equally as difficult.

It has been frequently stated that the voting trust was invented to achieve irrevocable proxies.[14] Although this device has met the theoretical objections to an irrevocable proxy, it has not, in and of itself, met the substantial objections based upon the abuses which such separation encourages.[15] Many of the arguments formerly urged against voting trusts still have force, although they go rather to their regulation than their abolition.[16] It is to be regretted that most voting trust statutes have been confined to authorizing their use while neg-

[10] Note (1947) 96 U. OF PA. L. REV. 121.

[11] Thus, the injured party may prefer to have those persons elected in violation of the agreement as directors, rather than those supported by shareholders not parties to the agreement.

[12] Although the voting trust encountered a great deal of opposition in its inception, it is now almost universally accepted, even in absence of statute expressly authorizing its creation. Mackin v. Nicollet Hotel, (C. C. A. 8th 1928) 25 F. (2d) 783; Bankers' Fire & Marine Ins. Co. v. Sloss (1934) 229 Ala. 26, 155 So. 371; Babcock v. Chicago Rys. Co. (1927) 325 Ill. 16, 155 N. E. 773; Brightman v. Bates (1900) 175 Mass. 105, 55 N. E. 809; Alderman *et al.* v. Alderman *et al.* (1935) 178 S. C. 9, 181 S. E. 897; Burke, *Voting Trusts Currently Observed* (1940) 24 MINN. L. REV. 347; Note (1936) 105 A. L. R. 123.

[13] 5 FLETCHER, CYC. CORPS. (Perm. ed. 1931) § 2079.

[14] ROHRLICH, LAW AND PRACTICE IN CORPORATE CONTROL (1933) 69.

[15] Ballantine, *Voting Trusts, Their Abuses and Regulation* (1942) 21 TEX. L. REV. 139, 147.

[16] *Id.* at 158.

lecting regulatory provisions which would safeguard them against the more common abuses.[17] This has cast upon the courts the burden of devising adequate remedies for the protection of the equitable owners of the pooled shares.[18]

Thus far, there seems to have been little attempt to define precisely the rights of the holder of a voting trust certificate. The voting trust was considered, by those who gave it legislative sanction, as a true trust,[19] and most courts have so regarded it.[20] When faced with problems concerning the duty of the trustees to the beneficiaries, the courts have adopted the controls and obligations imposed by the law of trusts generally. Thus, it is held that voting trustees are subject to the usual fiduciary duties to certificate holders,[21] and that they are removable on general trust principles.[22]

Many courts, however, have had difficulty in finding adequate protection for certificate holders in normal trust safeguards. It has been argued that since a trustee takes the entire legal title to personal property, all of the rights and privileges of ownership should vest in him, leaving nothing to the holders of trust certificates except the new trust relationship.[23] It may be conceded that the certificate holders have in form severed all direct contractual connection with the corporation, but it does not necessarily follow that they retain no beneficial interest in corporate affairs. Such a view overlooks the fact that the transfer of legal title consequent upon establishment of the voting trust has been made solely for the purpose of controlling the voting power of the shares. Nor is this result compelled by the law of trusts, since there seems to be no principle which dictates that the beneficiaries must surrender all rights with respect to property placed in trust, or that such rights may not be divided between the trustee and the benefici-

---

[17] Note (1947) 42 ILL. L. REV. 401, 405.

[18] The chief judicial limitation placed upon voting trusts has been the requirement of a valid purpose or object. See Note (1936) 105 A. L. R. 123.

[19] Gose, *Legal Characteristics and Consequences of Voting Trusts* (1945) 20 WASH. L. REV. 129, 131.

[20] Brown v. McLanahan (C. C. A. 4th 1945) 148 F. (2d) 703; Overfield v. Pennroad Corporation (E. D. Pa. 1941) 42 Fed. Supp. 586; H. M. Byllesby & Co. v. Doriot (Del. Ch. 1940) 12 A. (2d) 603; Kann v. Rosset (1940) 307 Ill. App. 153, 30 N. E. (2d) 204; Barbour v. Weld (1909) 201 Mass. 513, 87 N. E. 909; Wool Growers Service Corporation v. Ragan (1943) 18 Wash. (2d) 655, 140 P. (2d) 512. *Cf.* Warren v. Pim (Ct. Err. & App. 1904) 66 N. J. Eq. 353, 59 Atl. 773; National Liberty Ins. Co. v. Bank of America (Sup. Ct. 1926) 126 Misc. 753, 214 N. Y. Supp. 643 (holding that a court cannot appoint a successor trustee to fill a vacancy in the voting trusteeship, on the ground that a voting trust is not a "real trust").

[21] Brown v. McLanahan (C. C. A. 4th 1945) 148 F. (2d) 703; Wool Growers Service Corporation v. Ragan (1943) 18 Wash. (2d) 655, 140 P. (2d) 512; see Note (1945) 58 HARV. L. REV. 739, 740.

[22] Moore v. Bowes (1937) 8 Cal. (2d) 162, 64 P. (2d) 423; Lippard v. Parish (1937) 22 Del. Ch. 25, 191 Atl. 829.

[23] Gose, *supra* note 19, at 140.

aries.[24] Thus, for example, the mere fact that the trustees are deemed to have the right to inspect corporate records as incidental to their voting power does not necessarily require that such right be denied to certificate holders.

The difficulties which have arisen are therefore not necessarily inherent in "the fundamental trust status of the voting trust."[25] They result rather from the fact that much of the protection which shareholders now have has been provided through the medium of statutes. It is difficult to justify extension of such protection to certificate holders when it is apparent that in most cases the legislators contemplated "stockholders" as referring to shareholders of record. Some courts have found this difficulty insurmountable.[26] Others, however, have by decision extended the protection given by statute to "stockholders" to holders of voting trust certificates.

A notable example is the opinion in *Application of Bacon*,[27] where it was said: " . . . neither the holders of voting trust certificates nor the voting trustees possess all the rights of stockholders. Each group are 'stockholders' for some purposes—neither group for all purposes." It was held that certificate holders who objected to a proposed sale of the corporation's assets, approved by the trustees, were entitled to compensation rights accorded to dissenting shareholders by statute.

Similarly, other cases have held that a holder of a voting trust certificate may maintain an action to wind up an insolvent corporation,[28] may maintain a representative suit,[29] may contest an election of directors,[30] may inspect corporate records,[31] and is entitled to have appraisal of and compensation for his stock in case of a merger which

---

[24] A trustee has such powers as are specially conferred by the terms of the trust and such powers as are necessary or appropriate for the carrying out of the purposes of the trust and are not forbidden by the terms of the trust. 2 SCOTT, TRUSTS (1939) § 186. But the mere fact that the trustees are given certain rights and privileges attaching to corporate shares does not compel the conclusion that the certificate holders may not also have such rights.

[25] Compare Gose, *supra* note 19, at 140, where it is argued that "cases holding that the heneficiary of a trust is a 'stockholder' for certain purposes strike at the fundamental trust status of voting trusts . . . ."

[26] Bahcock v. Chicago Rys. Co. (1927) 325 Ill. 16, 155 N. E. 773 (certificate holders, not heing stockholders, had no right to inspect corporate records); State v. Sperry Corporation (Super. Ct. 1940) 41 Del. 84, 15 A. (2d) 661; *cf.* Atkins Corporation v. Tourny (1936) 6 Cal. (2d) 206, 57 P. (2d) 480; Salt Dome Oil Corporation v. Schenck (Del. Sup. Ct. 1945) 41 A. (2d) 583.

[27] (1941) 287 N. Y. 1, 5, 38 N. E. (2d) 105, 107.

[28] O'Grady v. United States Independent Telephone Co. (1909) 75 N. J. Eq. 301, 71 Atl. 1040.

[29] Hayman v. Morris (1942) 36 N. Y. S. (2d) 756.

[30] Chandler v. Bellanca Aircraft Corp. (Ch. 1932) 19 Del. Ch. 57, 162 Atl. 63.

[31] Brentmore Estates v. Hotel Barhizon, Inc. (1st Dep't 1942) 263 App. Div. 389, 33 N. Y. S. (2d) 331; Note (1942) 56 HARV. L. REV. 133.

has been approved by the trustees[32]—all under statutes conferring such rights upon "stockholders."[33]

The problem becomes more complex when the certificate holders are not the actual beneficiaries of the trust, as where the common stock is placed in trust for the protection of purchasers of preferred shares. This situation also arises quite frequently in corporate reorganizations where the voting trust is formed as part of the consideration for a loan to the corporation and for the protection of the lenders.[34] In such cases it is essential to define the precise rights and privileges of the transferors and also of those for whose benefit the voting power is to be exercised.

The efforts of courts to give holders of voting trust certificates some of the rights of "stockholders" indicate the need of protecting the beneficial owners of the shares from abuse. A comprehensive statutory regulation of voting trusts might provide such protection. It has been proposed that a more direct and efficient approach to the same objective could be achieved by recognition of the validity of irrevocable proxies, combined with statutory safeguards to take the place of revocability.[35] This suggestion, it is believed, deserves careful consideration.

In view of the ancient and well-settled doctrine favoring revocability of all proxies unless coupled with an interest, such a change, of course, must come from the legislature. It requires initially a statute authorizing voting agreements with joint voting representatives to act under irrevocable proxies from consenting shareholders, to be binding also on transferees.[36]

Recognition of irrevocable proxies would, at the outset, promote clarification of thought and concentration upon the basic problem, that of limitation and regulation of voting control devices. The confusion which has resulted from the attempt to adopt and regulate such devices by the employment of widely differing principles of agency and trust law would be eliminated. A rational and comprehensive policy could then be formulated.

Such an arrangement would automatically fulfill the desire of

---

[32] In re Universal Pictures Co. (Del. Ch. 1944) 37 A. (2d) 615.

[33] See also Wise v. Miller (1927) 215 Ala. 660, 111 So. 913; Scott v. Arden Farms Co. (Del. Ch. 1942) 28 A. (2d) 81.

[34] Mackin v. Nicollet Hotel (C. C. A. 8th 1928) 25 F. (2d) 783; Koplar v. Rosset (1946) 355 Mo. 496, 196 S. W. (2d) 800; Gottschalk v. Avalon Realty Co. (1946) 249 Wis. 78, 23 N. W. (2d) 606.

[35] Recognition of an irrevocable proxy was first advocated by Professor Ballantine in an article devoted to proposed regulation of the abuses and shortcomings of the voting trust. Ballantine, *supra* note 15, at 160. See also Gose, *supra* note 19, at 147.

[36] Ballantine, *supra* note 15, at 160. For a statute embodying several of Professor Ballantine's suggestions see (1945) FLA. GEN. LAWS c. 2298, as amended (1947) FLA. GEN. LAWS c. 24040.

many courts to preserve for holders of voting trust certificates certain shareholder rights. The parties would remain shareholders of record, retaining their rights of inspection, of disclosure, of derivative action, and any other rights not specifically delegated to the voting representatives. On ordinary agency principles, the authority of the representatives would be limited to that expressly and impliedly conferred in the agreement. By statutory requirement of registration of all voting agreements with the corporation, coupled with a provision that the corporation shall take notice of its terms, such limitations may be made binding upon the corporation.[37] Registration with the corporation, of course, would be essential for the purpose of rendering the agreement self-executing. The corporation must be informed of the fact, and extent, of surrender of voting rights so that it may enforce such surrender in the event of an attempted breach of the agreement by one of the shareholders.

Irrevocable proxies, like voting trusts, might easily be utilized to further interests contrary to those of the shareholders and the corporation.[38] Clearly, the voting representative would be an agent of the pooling shareholders, subject to the duties of an agent to his principal. But just as the fiduciary duties of the trustee have proved inadequate to protect the beneficial owners of the shares, so the duties imposed upon an agent would be inadequate. Therefore it is imperative that any authorization of a control device be accompanied by statutory regulation of the use of such device. Such regulation should include within its scope limitations upon the purposes for which a voting agreement may be formed,[39] the authority which may be delegated to the voting representatives, the conduct of the voting representatives, and the duration of the agreement.

The ease with which many credulous investors have been persuaded to part with their voting rights, and in form all other rights, in the past demonstrates the need of some limitation on the extent to which a shareholder should be permitted to part with his rights and safeguards. Shareholders should not be allowed to strip themselves

---

[37] California has enacted a similar provision with respect to voting trusts. CAL. CORP. CODE § 2230: "... If the voting trust agreement is filed in the office of the corporation, the corporation shall take notice of its terms and the limitations on the authority of the trustees thereunder."

[38] A classic example of abuse of the voting trust device was disclosed in Overfield v. Pennroad Corporation (E. D. Pa. 1941) 42 Fed. Supp. 586, where the voting trustees used their power for the benefit of another corporation, causing tremendous losses to the corporation whose shareholders they were representing. BALLANTINE, CORPORATIONS (Rev. ed. 1946) § 184a.

[39] Difficult questions of policy arise as to what limitations should be placed upon the purposes for which voting control devices should be considered permissible. Thus far, these questions have been left to the gradual solution of the courts. See BALLANTINE, CORPORATIONS (Rev. ed. 1946) § 184a.

entirely of their voting power so as to authorize the representatives to vote on fundamental changes such as dissolution, merger, sale of entire assets, or amendment of the articles of incorporation.[40] Irrevocable delegation of such rights might well be forbidden.

Although the law of agency would impose some check upon the conduct of the representatives, specific statutory restrictions limiting personal transactions with the corporation would seem advisable. Also, provision for reports and full disclosure of the method in which the delegated power is exercised might well be made. The representatives should be subject to removal for abuse of authority at the suit of any party to the agreement.[41]

Statutory limitation upon the permissible duration of a voting agreement is customary and important. Again it would seem advisable to protect unwary shareholders from their own improvidence. A shareholder should not be bound by a voting agreement, without opportunity to escape, for an unduly long period of time. Similarly, some provision should be made for termination by majority vote of the parties, with an exception where the agreement has been formed for the protection of persons other than the participating shareholders.

If greater regulation of voting agreements is felt advisable, they may be made subject to administrative supervision. A step in this direction has been taken with respect to voting trusts under the California Corporate Securities Act[42] and the Securities Act of 1933,[43] but as yet there is no indication that this form of regulation will be widely adopted. However, requirement of administrative approval and subjection to administrative scrutiny seem to offer far greater protection to investors than any other safeguards.[44]

Although the above statutory safeguards have been outlined as

[40] Ballantine, *supra* note 15, at 165.

[41] A representative might also be made subject to removal without cause by majority vote of the parties to the agreement, except where the agreement was formed for the protection of such representative.

[42] The California Corporate Securities Act requires that a permit be obtained from the Corporation Commissioner before issuance of any security by a company. CAL. GEN. LAWS (Deering, 1944) Act 3814 (Calif. Corporate Securities Act, §§ 2(a) 7, 16, 26). This Act was interpreted by the Division of Corporations as giving power to regulate, approve or deny formation of voting trusts, and it was held in Barney v. First National Bank of Monterey (Cal. App. 1939) 90 P. (2d) 584 that where no permit had been obtained prior to issuance of trust certificates, both the certificates and the entire trust agreement were void. However, considerable doubt has been cast upon this interpretation by an implication in a recent District Court of Appeals decision to the effect that the law contains no requirement for approval of voting trusts by the State Corporation Commissioner. Boericke v. Weise (1945) 68 Cal. App. (2d) 407, 156 P. (2d) 781; see Note (1945) 33 CALIF. L. REV. 321.

[43] Under the Securities Act of 1933, a registration statement must be filed with the Securities and Exchange Commission before issuance of voting trust certificates. See C. C. H. FED. SEC. LAW SERV. Form F-1, pp. 3641-3647-2.

[44] Ballantine, *supra* note 15, at 163; Note (1947) 42 ILL. L. REV. 401, 406.