

The Conduct of Corporate Elections

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THE CONDUCT OF CORPORATE ELECTIONS

THE annual election of directors in corporations having many stockholders generates problems that are not unlike the problems arising from the conduct of political elections. But whereas the conduct of political elections is narrowly protected by statutory enactments,¹ corporate elections are, for the most part, conducted under the personal jurisdiction of corporate management and its lawyers.

It is not surprising, therefore, that with the recent governmental trend toward the supervision of corporate activities, at least in their financial aspects, there should also appear an increasing awareness of the need for the supervision of corporate elections. The twin evils of apathy and lack of adequate information beset the average corporate stockholder and prevent him from exercising an intelligent choice in the selection of corporate directors. Nor do we have, in the case of private corporations, the assistance of an alert and critical press, the facilities of the radio, nor the activities of public-spirited men, all devoted to the task of enlightening the voters. Stockholders are dependent for their knowledge with respect to the merits of particular candidates upon information supplied by the candidates themselves or by rival interests who desire to replace existing management.

The usual proxy contest, as far as the individual stockholder is concerned, consists in the receipt by him of numer-

¹ See, for example, the Election Law of the State of New York, being Chapter 17 of McKinney's Consolidated Laws, prescribing forms of ballots and rules with respect to the preservation of books and papers, Sections 100-124, and giving detail regulations with respect to the conduct of elections, Sections 190-229.

ous letters from rival candidates for office. Frequently, the letters are confusing; often, they flatly contradict each other. The stockholders frequently find it impossible to ascertain the facts, or at least to credit the representations by competing claimants to office. Where personal solicitors are employed, it is, of course, impossible to control extravagant claims made by them to induce stockholders to vote, and there are few opportunities for the average stockholder to check these claims. Professional proxy solicitors, a well paid sector of the financial community, are skilled in the knowledge of the psychology of corporate investors and know just what type of argument to make that would appeal most to them.

The apathy of the average stockholder arises from the realization that his small stockholding could hardly affect the result and the feeling that the situation is, in any event, controlled by the larger stockholders. It is for this reason that frequently the ownership of only 10% of the outstanding stock is sufficient to secure a majority of votes, sufficient to elect the board.

There is an amazing paucity of statutory regulations with respect to the conduct of corporate elections. In New York, for example, the election need not be held at all, unless it is demanded by some stockholder, and the conduct of the election itself, the manner of voting and the form and contents of notices and requests for proxies, are practically without statutory prescription.² Nor are there more extensive provisions in other states. What protection there is, derives from the new administrative controls set up by the Securities and Exchange Commission,³ from certain established principles of law, and from the strong arm of equity, interposed when the results of elections are challenged in the courts. The analysis of these safeguards and the evaluation of their utility and effectiveness is the subject matter of this paper.

² The right to vote by proxy is in New York provided for in Section 19 of the General Corporation Law, and the only provision with respect to it is that the proxy must be in writing and shall not be valid after the expiration of eleven months from its date, and shall be revocable at pleasure. No other regulations with respect to the proxy are contained in the statute.

³ See the SECURITIES ACT OF 1934, U. S. C. A., tit. 15, § 78n, giving to the Securities and Exchange Commission the right to make rules and regulations with respect to proxies, and providing that no one shall solicit or give a proxy unless in conformity with such regulations.

QUORUM

The first essential of a proper election of directors is, of course, the presence of a quorum at the meeting. There seems to have been no rule at common law with respect to the number of shareholders required to constitute a quorum, and a plurality of those actually present at the meeting was generally deemed sufficient to effect a valid election.⁴ This has been changed by statute in most states, which now generally provide that the by-laws may fix the percentage of the stockholders necessary to constitute a quorum.⁵ In New York, the statute provides that the by-laws "may fix the number of shares, not exceeding a majority necessary to constitute a quorum". But even this salutary provision may be easily evaded. It will be noted that Section 55 of the Stock Corporation Law, which authorizes the inclusion in the by-laws of a provision fixing the percentage of shareholders that might constitute a quorum, applies only to the regular meeting of stockholders. But this regular annual meeting need not, as we have seen, be held, and the only penalty for not holding it is that the stockholders may demand that a special meeting be called for the election of directors.⁶

⁴ 2 KENT'S COMM. *293. As a matter of fact, until the adoption of Section 55 of the Stock Corporation Law in 1930, the New York statute likewise provided that "the directors of every stock corporation shall be chosen at the time and place fixed by the by-laws of the corporation by a plurality of votes at such election" (former § 25, STOCK CORP. LAW).

Under that section, it was held that a by-law making a fixed percentage of the outstanding stock necessary for a quorum was invalid as in conflict with the statute (Matter of Keogh, Inc., 192 App. Div. 624 [1920]; Matter of Rapid Transit Ferry Co., 15 App. Div. 530 [1897]; Ripin v. U. S. Woven Label Co., 205 N. Y. 442 [1912]; Matter of Boulevard Theatre & Realty Co., 195 App. Div. 518, 186 N. Y. Supp. 430, *aff'd without opinion*, 231 N. Y. 615, 132 N. E. 910 [1921]).

⁵ N. Y. STOCK CORP. LAW § 55. See, however, in the case of special elections, Section 23 of the General Corporation Law, providing that those attending shall constitute a quorum. COLO. CORP. LAW § 27; KANSAS G. S. SUPP. § 17-3305; Louisiana, L. 1928, Act 250, § 31; Ohio, G. C. § 8623-43; Rhode Island, G. C. § 22; South Carolina, C. L. § 7679; Utah, § 18-2-42; Vermont, § 5811; Virginia, Code § 3796.

⁶ The New York statute, Section 55 of the Stock Corporation Law, limits the power of the by-laws by providing that a quorum may not exceed a majority. The only provision, however, for failing to call the annual meeting for the election of directors is contained in Section 22 of the General Corporation Law, which provides that the directors shall forthwith call a special meeting for the election of directors or, upon their failure to do so, any member of the corporation may call such meeting. At special meetings, however, Section 23 of the General Corporation Law provides that "the members attending shall constitute a quorum".

With regard to special meetings, Section 23 of the General Corporation Law applies, and by its terms, those attending constitute a quorum. It has been held that a by-law in conflict with Section 23 of the General Corporation Law is invalid.⁷ Accordingly, a simple method is available to the management of a corporation for avoiding the limitations with respect to a quorum contained in the by-laws. All that is needed is that the management shall fail to call the annual meeting and when a special meeting is demanded, Section 23 of the General Corporation Law specifically provides that those attending shall constitute a quorum. Since this section supersedes any contradictory by-law that may exist, the management is thus enabled to conduct an election without the limitations contained in the by-laws with respect to a quorum.⁸

In practice, this device is not commonly used as it might work against the management as often as it does for it. But the existence of the possibility is a defect in our statutory scheme, not contemplated by the law makers and should, of course, be corrected.

INSPECTORS OF ELECTION

The ballots which are cast at a corporate meeting for the election of directors are generally tabulated by officials who, in this state at least, are called inspectors of election.⁹

⁷ See *Matter of Rapid Transit Ferry Co.*, 15 App. Div. 530, 44 N. Y. Supp. 539 (1897); *Reiss v. Levy*, 175 App. Div. 938, 161 N. Y. Supp. 1048 (1916).

⁸ As a matter of fact, the General Corporation Law of Nebraska, Section 31, specifically enacts the possibility of this evasion. The statute provides that

"If the election for directors of any such corporation shall not be held on the day designated by the by-laws, the directors shall cause the election to be held as soon thereafter as conveniently may be; . . . and at such election the shares of stock represented at such meeting, either in person or by proxy, shall constitute a quorum for the purpose of such election notwithstanding any provision of the by-laws of the corporation to the contrary."

⁹ Section 20 of the General Corporation Law authorizes the inspector of election to administer an oath to anyone whose vote is challenged.

Section 23 of the General Corporation Law authorizes those present at a special meeting to elect inspectors.

Section 24 of the General Corporation Law requires the inspectors to file a certificate, giving the result of the election together with their oath as inspectors.

The method of selecting inspectors of election is frequently provided for in the by-laws. They are required to take an oath to the effect that they will impartially and fairly conduct the election and tabulate the votes, and are authorized to administer an oath of regularity to any stockholder or proxy holder whose vote is challenged. Here again, there are no safeguards which may be employed at the meeting by minority groups to insure a fair count. But since the action of the inspectors is, as we shall see, reviewable in court and fraudulent conduct on the part of the inspectors would constitute a violation of the criminal law, it may perhaps not be necessary, in the ordinary case, to provide for any official safeguards with respect to the conduct of the inspectors. However, there appears to be some need for legislation requiring the inspectors to keep their records and to make available the ballots which have been cast to examination by any dissatisfied stockholder.

The duties of the inspectors with respect to counting the votes are largely ministerial. It is not for them to say whether a particular shareholder or proxy holder has the right to cast his vote or whether the proxy was properly obtained or whether any other equities exist sufficient to disfranchise the particular voter.¹⁰ They are governed by the provisions of Section 47 of the Stock Corporation Law. This section gives every stockholder of record a vote for every share of stock that he owns, either in person or by proxy. All that the inspectors, therefore, are required to do is to consult the official list of stockholders and to make sure that the tendered ballots are signed by stockholders whose names appear on the official

Section 46 of the Stock Corporation Law provides for the appointment of inspectors, as provided in the by-laws, or, upon failure of such provision, the stockholders may by a per capita vote choose temporary inspectors. Inspectors are entitled to reasonable compensation.

¹⁰ Section 47 of the Stock Corporation Law provides that each shareholder of record shall be entitled, at every meeting of the corporation, to one vote for each share of stock recorded in his name. It also provides that such shareholder may vote in person or by proxy, and also provides that the owner of stock which stands in the name of another may demand from such other a proxy to vote thereon. It also gives to the inspectors the right of examining the original stock books of the corporation. The duties of the inspector under this section are, therefore, to compare the votes cast with the stock records of the corporation, and if the votes are in accordance with Section 47, they are valid and must be counted.

list, or that the proxies which are offered by proxy holders are signed in like manner.

In spite, however, of the apparent simplicity of this task, numerous questions arise which the inspectors must resolve. May the administrator or executor of an estate vote or sign a proxy for shares standing in the name of the decedent;¹¹ may one of two joint owners of stock vote the shares on behalf of both;¹² what shall be done with undated proxies;¹³ what disposition shall be made of two proxies from the same stockholder, running to different persons, signed apparently on the same date;¹⁴ what shall be done with informal proxies, such as proxies which are not witnessed or which are contained in a telegram?¹⁵ Some of these questions find ready answers in the decisions, as we have noted in the margin. Others are the subject of conflicting authority. These problems, however, are of comparatively minor importance since in large corporations, at least, the number of such proxies is very seldom large enough to affect the result.

Once the inspectors have filed their report, it is the duty of the presiding officer to declare the candidates having received a plurality of votes to be elected.

JUDICIAL REVIEW

The method of contesting the result of an election is, in most states, a proceeding in the nature of *quo warranto*, to

¹¹ Apparently, in order to permit an executor or administrator to vote, his letters testamentary, or a copy of the will with his authority, should accompany the proxy or be provided shortly after the election. See *Warner v. Hoagland*, 51 N. J. L. 62 (1888).

¹² That the consent of all the joint owners of stock is necessary to vote it, see *Hey v. Dolphin*, 92 Hun 230 (N. Y. 1895); *Matter of Pioneer Paper Co.*, 36 How. Pr. 111 (N. Y. 1865). But it has also been held that a share of stock held in the name of two or more persons may be voted under a proxy given by one of them (*Gow v. Consolidated Copper Mines Corp.*, 19 Del. Ch. 172, 165 Atl. 136 [1933]).

¹³ *In re Election of Directors of St. Lawrence Steamboat Co.*, 44 N. J. L. 529 (1882).

¹⁴ Apparently a later proxy revokes an earlier; but if the proxies do not show which one is later because they are both undated, or both dated on the same day, they must both be rejected (*Pope v. Whitridge*, 110 Md. 468 [1909]).

¹⁵ *Smith v. San Francisco & N. P. Ry.*, 115 Cal. 584, 47 Pac. 582 (1897); *Gentry-Futch Co. v. Gentry*, 90 Fla. 595, 106 So. 473 (1925); *In re Election of Directors of St. Lawrence Steamboat Co.*, 44 N. J. L. 529 (1882).

try the title of the directors to their office.¹⁶ In New York and in many other states, however, there are specific statutory proceedings for the review of corporate elections. Thus, Section 25 of the General Corporation Law authorizes the Supreme Court, upon application of any member aggrieved by an election, and upon notice to the persons who have been declared elected thereat, to hear proof with respect to the propriety of an election and to make an order either confirming the election or ordering a new election, as the justice of the case may require.¹⁷

The scope of this review and the relief to be secured thereunder has been the subject of considerable litigation. Some have taken a broader view of the powers of the Supreme Court under this section.

It is, first of all, important to point out that a proceeding under Section 25 of the General Corporation Law cannot be availed of for the purpose of trying title or settling equities between rival claimants to particular shares of stock.¹⁸ For the solution of such problems, the litigants are relegated to the ordinary remedies at law and in equity. Here, the court is only concerned with the propriety and fairness of the election.

Again, it should be remembered that if the petition, even if granted, would not have the effect of changing the result of the election, the court will not consider it. No matter what errors the inspectors may have made or what irregu-

¹⁶ See CAL. CIVIL CODE § 312; DEL. GEN. CORP. LAW § 31; MO. REV. STAT. 1919, § 9767; N. J. COMPILED STAT. 1910, p. 1624, § 42; N. Y. GEN. CORP. LAW § 25; N. C. CONSOL. STAT. 1919, § 1177; R. I. GEN. L. § 5778; VA. CODE OF 1930, § 3804.

The common law rule required the bringing of *quo warranto* in the name of the People. *Elberta Oil Co. v. Superior Court of California in and for Kings County*, 74 Cal. App. 114, 239 Pac. 415 (1925).

¹⁷ General Corporation Law, Section 25, reads as follows:

"Powers of supreme court respecting elections. Upon the application of any member aggrieved by an election, and upon notice to the persons declared elected thereat, the corporation and such other persons as the court may direct, the supreme court at a special term thereof shall forthwith hear the proofs and allegations of the parties, and confirm the election or order a new election, as justice may require."

¹⁸ *Matter of Utica Fire Alarm Teleg. Co.*, 115 App. Div. 821 (1906). In this case, the court pointed out that where the right to vote is involved, the record ownership of the stock is controlling, and that equities between the record owners and others cannot be settled in a proceeding under Section 25 of the General Corporation Law.

larities may have existed in the tabulation of the votes, they are of no consequence if the result would have been the same in any event.¹⁹

The court, unlike the inspectors, is not bound to perform a mere ministerial act of reviewing the count. The court may disregard forged proxies; may take evidence with respect to the problem of whether the person who voted is in fact the same person whose name appears on the official list; may pass upon the authority of fiduciaries to cast votes; and, above all, as has been held in recent years, may enter into the vexatious problem of determining whether any fraud or overreaching has been practiced in connection with the conduct of the election, either at the meeting or prior thereto.²⁰ The chief problem in respect to this last matter is to ascertain whether the contending parties have resorted to any overreaching in the campaign for votes or proxies; whether there has been any misstatement or concealment of important or relevant matters from the security holders, and whether the campaigns were conducted in a fair and equitable manner.

Laying aside, for a moment, the numerous difficulties that would beset a petitioner in order to prove the nature of an unfair campaign for election, we shall first consider what it is that the courts have on the whole regarded as unfair.

¹⁹ *Matter of Argus Co.*, 138 N. Y. 557 (1893); *People ex rel. Osborn v. Tuthill*, 31 N. Y. 550 (1864); *Philips v. Wickham*, 1 Paige 590 (N. Y. 1829).

²⁰ *Matter of Kaminsky*, 251 App. Div. 132, 295 N. Y. Supp. 989 (1937), *rearg. denied*, 251 App. Div. 795, 298 N. Y. Supp. 171 (1937), *aff'd*, 277 N. Y. 524, 13 N. E. (2d) 456 (1938); *Matter of Bogart*, 215 App. Div. 45, 213 N. Y. Supp. 137 (1925); *In re Green Bus Lines*, 166 Misc. 800, 2 N. Y. S. (2d) 556 (1937); *In re Flushing Hospital & Dispensary*, 27 N. Y. S. (2d) 207 (1941), *aff'd*, 28 N. Y. S. (2d) 155 (1941), *rearg. denied*, 29 N. Y. S. (2d) 151 (1941), *mod'd on other grounds and aff'd*, 288 N. Y. 125, 41 N. E. (2d) 917 (1942); *Matter of Prophet*, 236 App. Div. 524, 260 N. Y. Supp. 239 (1932); *Di Silvestro v. Sons of Italy Grand Lodge*, 130 Misc. 494, 223 N. Y. Supp. 791 (1927).

For the same rule in other states, *see Pierce Oil Corp. v. Voran* (Va.), 118 S. E. 247 (1923); *Stratford v. Mallory*, 70 N. J. L. 294 (1904); *In re Zenitem Co.*, 95 N. J. L. 297 (1921); *Lawrence v. I. N. Parlier Estate Co.* (Calif.), 100 Pac. (2d) 765 (1940).

In the following cases, however, it was held that the interposition of equity to determine the validity of an election will only be permitted as an incident to a suit for other relief: *Nathan v. Tompkins*, 82 Ala. 437, 2 So. 747 (1887); *Sheehy v. Barry*, 87 Conn. 656, 89 Atl. 259 (1914); *Walker v. Johnson*, 17 App. Cas. 144 (D. C.); *Gentry-Futch Co. v. Gentry*, 90 Fla. 595, 106 So. 473 (1925); *Chicago Macaroni Manufacturing Co. v. Boggiano*, 202 Ill. 312, 67 N. E. 17 (1903).

General statements are not wanting. Thus, the Appellate Division, in a case subsequently affirmed in the Court of Appeals, said :

On the other hand, if reasonable grounds exist to indicate that the election under review has not been conducted in a proper, regular or fair manner, it should not be confirmed. If the result is not free from suspicion, or is clouded with doubt, and justice demands, we may in all fairness require the parties to start over again. When right, justice and fair play require, a new election should be ordered.²¹

It will be observed that this statement, which succinctly states the law, at least in this jurisdiction, is very broad and will of necessity suggest many problems in an effort to apply the principle to various states of fact. The essence of the doctrine, however, is not difficult to analyze. Under it, the chancellor exerts his power to assure to the stockholders of a corporation the full enjoyment of their legal right freely to express and effectuate their wishes in regard to a corporate election.

Strangely enough, until very recently, there was not a single instance in which a corporate election in a business corporation has been set aside on this equitable ground. The gap was filled recently in a case decided by Mr. Justice Hofstadter, in the Supreme Court in New York County. Here, the result of an election was challenged on the ground that the proxies voted for the successful candidates had been obtained by overreaching and concealment. The specific acts of overreaching and concealment were comparatively simple. They consisted of a statement contained in a letter sent by a committee to the stockholders, the veracity of which was challenged, and of the failure to disclose that a brokerage house, which had written to the stockholders recommending the successful candidates, had received compensation therefor not from the candidates but from their backers. The false statement was as follows :

Mr. Scheuer refers to the reduction in the net earnings, notably during the past two years. However, he fails to point out that in these two years over \$60,000 was charged against earnings because of

²¹ See *In re Kaminsky*, *supra* note 20, at pp. 139-140.

improvements and the new equipment and furniture and the maintenance thereof.

The facts, as proved at the trial before the special master, were that \$60,000 had indeed been spent but that the sum had been charged to capital and not deducted from earnings, and could not be utilized as a mode of explaining the decline in earnings. It was, however, true that the maintenance of the new equipment would explain a large portion of the \$60,000, and this item was charged against earnings. Nevertheless, the special master, in considering this aspect of the case, said:

This statement was definitely inaccurate and misleading. Not one penny was charged against earnings by reason of the purchase of new equipment and furniture, or either of them, for these items were capitalized. Mr. Bennett of Barrow, Wade, Guthrie & Co., accountants for the corporation, admitted this point-blank. As to the maintenance item, the impression was given that this represented some unusual expenditures for these two years. The entire inference created was that these extraordinary items aggregating \$60,000 accounted for the decline in earnings, and that petitioner had given the stockholders a false picture by omitting to state this fact.

With respect to the concealment, the special master was more outspoken. The letters were sent by a well known firm of brokers to all of the security holders of the corporation, and advised the election of the successful candidates. Nothing in the letters was charged to be untrue, and the difficulty was that the recipients were not advised that the brokerage firm had received a small sum of money as consideration for having written the letters. The special master characterized these letters as "offensive communications", and said that in his opinion, "whether unwittingly or not, a deception was practiced upon the stockholders, which may well have influenced a number of them."²²

This recent decision by a court of learning and ability is a significant exposition of the principles of equity governing the conduct of corporate elections. By the extrapolation of its principles, the case will ultimately be seen to stand for

²² The case referred to is *In the Matter of the Application of S. H. Scheuer in respect to the Election of Directors of London Terrace, Inc.*, N. Y. L. J., Oct. 2, 1942.

the proposition that rival candidates for election in corporations are compelled to make full disclosure of all the facts and circumstances surrounding their candidacy, and that concealment of material and essential facts, which might have a tendency to sway the stockholders, is as pernicious as actual misrepresentation. Both may be dealt with in equity and may form the basis for ordering a new election.

ADMINISTRATIVE CONTROL

The Securities Exchange Act of 1934 conferred power on the Securities and Exchange Commission, as we have seen above, to adopt regulations with respect to the solicitation of proxies.²³ The Securities Commission early adopted regulations with respect to the circumstances under which proxies may be solicited. From time to time, these regulations have been revised, and both the original regulations as well as the revisions have been the subject of wide discussion in the financial community. The general purpose of the regulations has been to make available to security holders all of the information necessary to exercise a judgment with respect to whether or not a proxy should be given to a particular soliciting agency. The original regulations required merely the filing of certain information with the Commission. Extensive criticism, however, of the results obtained under these early regulations, which led to the feeling among many that while the regulations were being literally lived up to, their spirit was being evaded, led to a movement for the revision of the

²³ "78n. *Proxies*

(a) It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of any national securities exchange or otherwise, to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security (other than an exempted security) registered on any national securities exchange in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(b) It shall be unlawful for any member of a national securities exchange or any broker or dealer who transacts a business in securities through the medium of any such member to give a proxy, consent, or authorization in respect of any security registered on a national securities exchange and carried for the account of a customer in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

proxy regulations of the Securities and Exchange Commission.²⁴ As a result of this agitation, the Commission, on October 18, 1942, announced a complete revision of its proxy rules, effective January 15, 1943.²⁵

These new regulations require soliciting agencies to furnish each person who is solicited with specifically detailed information, described in the regulations, and also require the filing of this material with the Commission. Careful adherence to the letter and spirit of these regulations, it is argued, will result in making available to stockholders generally full and complete information, on the basis of which they can exercise an intelligent judgment. It has, on the other hand, been argued that the rules are so detailed and onerous as to render it impossible for the management or other soliciting agencies to comply with them, and that, in any event, the detailed information required to be submitted to the security holders is meaningless to most stockholders, who are not versed in finance or in the intricacies of corporate management, or who do not have the time or opportunity to make studies with respect to these matters.

It is too soon to be able to say what the practical result or effect of these regulations has been upon the conduct of corporate elections. The whole problem of the regulation of corporate management, which gave rise to the creation of the Securities and Exchange Commission, the Securities Act of 1934, the Investment Company Act, the Trust Indenture Act, the Public Utility Holding Company Act, is still to a large extent unsolved. The experiences being collected by the Commission, however, will undoubtedly point the way toward more democratic control of American business corporations.

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²⁴ "Your Investments", vol. 3, Sept. 1942, pp. 1-17.

²⁵ See SECURITIES AND EXCHANGE COMMISSION RELEASE, Dec. 29, 1942, Reg. X-14, *et seq.*