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Corporations--Voting Agreements Among Stockholders--The "Damage Test" (Clark v. Dodge, 269 N.Y. 410 (1936))

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CORPORATIONS—VOTING AGREEMENTS AMONG STOCKHOLDERS—THE "DAMAGE TEST."—An agreement between the plaintiff and the individual defendant—both owning all the stock—provided that the defendant as majority stockholder and director would by his voting power continue plaintiff as director and general manager of one of the two co-defendant corporations, provided plaintiff remained faithful and efficient. By way of salary or dividends the plaintiff was to receive one-fourth of the net income of the two corporations and no unreasonable salaries were to be paid to other officers. In consideration thereof, the plaintiff agreed to disclose certain secret manufacturing formulae to the defendant's son and at his death if no issue survived him to bequeath his stock to defendant's family. In an action for specific performance, the Appellate Division dismissed the complaint on authority of *McQuade* v. *Stoneham,*[1] claiming the contract violated Section 27 of the General Corporations Law.[2] *Held,* reversed. A contract among stockholders the enforcement of which injures nobody though it impinges slightly upon the broad provisions of Section 27,[3] will not be held illegal, a practical test to see if any damages were suffered or threatened, by the contract, being applied by the court. *Clark* v. *Dodge,* 269 N. Y. 410, 199 N. E. 641 (1936).

The courts have strictly construed Section 27 [4] respecting contracts among stockholders to control the actions of directors. Decisions have pointed out that it makes no difference whether the bargain was morally corrupt or not, or whether it was intended to be in the best interests of the corporation.[5] Voting agreements among stockholders to maintain men in office by their powers as directors or stockholders have been voided [6] on the theory that they violate the right each stockholder has to have the others vote independently.[7] Though a stockholder may vote as he pleases, public policy, it was argued, forbade agreements among them to continue directors in office.[8] Very often, the contract was invalidated [9] for slightly en-

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[1] McQuade v. Stoneham, 263 N. Y. 323, 189 N. E. 234 (1936).

[2] N. Y. GEN. CORP. LAW § 27: "The business of the corporation shall be managed by its board of directors."

[3] *Ibid.*

[4] *Ibid.*

[5] Snow v. Church, 13 App. Div. 108, 42 N. Y. Supp. 1072 (2d Dept. 1897).

[6] Lothrop v. Goudean, 142 La. 342, 76 So. 794 (1917); Woodruff v. Wentworth, 133 Mass. 309 (1882); Teich v. Kauffman, 174 Ill. App. 306 (1912).

[7] 71 A. L. R. (1931) 1289, 1290.

[8] Holdman v. Holdman, 176 Ky. 635, 197 S. W. 376 (1917); West v. Camden, 135 U. S. 507, 10 Sup. Ct. 838 (1890) (An agreement by the director of a corporation to keep another permanently in place as an officer of the corporation was declared void as against public policy though there was to be no direct gain to the promisor.).

[9] McQuade v. Stoneham, 263 N. Y. 323, 189 N. E. 234 (1934) (Defendants, owners of the majority stock of the National Exhibition Co., agreed with plaintiff, also a stockholder, to use their best endeavors to establish both the plaintiff and themselves as directors of the corporation and as officers at a specified salary. Subsequently the plaintiff was dropped from his position with the defendants' acquiescence and the court would not enforce the agreement

croaching on the statutory norm.[10] This view was soundly criticized in the dissenting opinion of *McQuade* v. *Stoneham*[11] where Lehman, J., held that a contract, the purpose of which is not illegal, should not be held void. He thus inferred that if no one is to be damaged, the agreement was to be upheld.[12]

In the instant case[13] the Court of Appeals comes to a contrary and more logical conclusion than in *McQuade* v. *Stoneham*.[14] Naturally the fact that the contracting parties were the sole stockholders influenced the court.[15] But it is by the application of the "damage test"[16] that the court arrives at its decision. Since neither the contracting parties nor any others were injured or threatened with injury, the court felt that the contract should be upheld. This test has consciously or by implication been applied in many prior instances.[17] *Manson* v. *Curtis*[18] clearly showed that it was legal for a minority of stockholders controlling the majority of stock to unite upon a corporate course of action or election of certain persons, provided no illegal object was sought or no statute expressly contravened. Should the agreement seek to perpetrate a fraud and thus injure others the courts could take jurisdiction for the protection of the minority.[19]

Clark v. *Dodge*[20] does not hold that the powers of directors may be sterilized[21] but is in line with those cases declaring that the powers of directors may be limited if nobody is affected.[22] Thus the courts of New York have laid down the rule that Section 27[23] will not be strictly construed but that each case will be decided on its facts and by the application of a very logical "damage test".

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claiming that it precluded directors from changing or continuing officers except by consent of the contracting parties.).

[10] N. Y. GEN. CORP. LAW § 27.

[11] McQuade v. Stoneham, 263 N. Y. 323, 189 N. E. 234 (1934).

[12] Lehman, J., "Public policy should be governed by facts, not abstractions."

[13] Clark v. Dodge, 269 N. Y. 410, 199 N. E. 641 (1936) (The court in this case limits the McQuade v. Stoneham decision to its own particular facts).

[14] McQuade v. Stoneham, 263 N. Y. 323, 189 N. E. 234 (1934).

[15] Landlord v. Clyde, 86 N. Y. 384 (1881); Drucklieb v. Harris, 209 N. Y. 211, 102 N. E. 599 (1913); Kassell v. Empire Tinware, 178 App. Div. 176, 164 N. Y. Supp. 1033 (2d Dept. 1917). The courts have always been more liberal where the contracting parties have been the sole stockholders.

[16] Note (1928) 28 COL. L. REV. 366, 372.

[17] Manson v. Curtis, 223 N. Y. 313, 119 N. E. 559 (1918); Thompson v. Thompson Carnation Co., 279 Ill. 54, 116 N. E. 648 (1917).

[18] Manson v. Curtis, 223 N. Y. 313, 119 N. E. 559 (1918).

[19] Weber v. Della Mountain Min. Co., 14 Idaho 404, 94 Pac. 441 (1908); Venner v. Chicago City R. R. Co., 258 Ill. 523, 101 N. E. 449 (1913).

[20] Clark v. Dodge, 269 N. Y. 410, 199 N. E. 641 (1936).

[21] This was the reason for the decision in Manson v. Curtis, 223 N. Y. 313, 119 N. E. 559 (1918).

[22] Ripin v. U. S. Woven Label Co., 205 N. Y. 442, 98 N. E. 855 (1912).

[23] N. Y. GEN. CORP. LAW § 27.