

Corporate Voting Trusts--Validity--Banks

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bankruptcy contrary to express provisions of the lease,¹²—quite apart from this expressed abhorrence of forfeitures which the courts have so clearly enunciated, it would appear that an action by the lessor against his lessee is in every particular identical with an action against his transferee rather than with an action by the lessee against the transferee of the lessee in possession.

Mr. Justice Wagner in the case cited above,¹³ definitely classifies this group of cases with the second group mentioned above and the outstanding similarity, of course, is that in both cases the action is by the immediate transferor against his immediate transferee and it is to enforce covenants between the parties themselves and not equities which result from privity of estate.

Where the landlord prefers to sue for damages rather than to enforce his supposed right to have the estate forfeited, or where he prefers to evict the transferee of the lessee, the situation very closely resembles that in the O'Connell case, *Supra*, and we have seen how the court reacted in that situation. It is not therefore unlikely that the courts will so extend that reasoning and in all of these cases where the landlord is seeking either to forfeit or enforce his lease, that the transferring instrument will be regarded as a sub-lease rather than an assignment. The situation then boils down to this: that in nearly every case very slight differences in content between the transferring instrument and the main lease will suffice to constitute the latter a sub-lease rather than an assignment, particularly when the result will help to avoid forfeiture but that in the sole instance where the lessor is suing the transferee of the lessee in possession to enforce covenants in the original lease, this rule will be considerably relaxed and the instrument will be regarded in nearly every case as an assignment in order to enable the landlord to obtain the benefits of his property. P. L.

"CORPORATE VOTING TRUSTS—VALIDITY—BANKS"—In a recent case¹ which involved the validity of a voting trust agreement (under statute²) the material facts were, that in December 1924, certain stockholders of a

¹² *Gazley v. Williams*, 210 U. S. 41 (1907).

¹³ *O'Connell v. Sugar Products Co.*, *supra*, note 1.

¹ *National Liberty Insurance Co. v. Bank of America*, 214 N. Y. Supp. 643 (Sup. Ct. 1926) *rev'd*, 217 N. Y. Supp. 67 (App. Div. 1926) *Tompers v. Bank of America*, *ibid*.

The two cases are identical with a very slight exception and were considered at the same time.

² Sec. 50 Stock Corporation Law in part, "A stockholder, by agreement in writing, may transfer his stock to a voting trustee or trustees for the purpose of conferring the right to vote thereon for a period not exceeding ten years. Every other stockholder may transfer his stock to the same

bank entered into a voting trust agreement whereby the individual defendants, who were directors of the bank, were designated as trustees. In March 1925, an amendment³ to the aforementioned statute was passed which prohibited the stockholders of banks from making such agreements.

Prior to the passing of the amendment less than one-third of the stock had been deposited with the trustees pursuant to the agreement. Subsequent to the passing of the amendment the trustees obtained further deposits so as to obtain a majority. The actions, brought by a stockholder and by a holder of trust certificates,⁴ sought to enjoin the individual defendants from voting and the bank from receiving such votes cast from certificates issued under the trust agreement.

The Appellate Division in reversing the ruling of the Supreme Court at Special Term held that such trusts were not void per se and against public policy. It further held that in the absence of express language in the amendment a statute is merely prospective in effect and could not invalidate transactions made under or entered into prior to the enactment of the amendment.

The question of the validity of voting trust agreements dehors a statute is one which apparently cannot receive a categorical answer, for each state has its own rules of law and its own policies shaped by a medley of causes. Many states have neither statutes nor judicial decisions upon the question propounded.⁵

trustee or trustees and thereupon shall be a party to such agreement." Derived from sec. 25 of General Corporation Law. That section was derived from L. 1892 ch. 687, which added a new sec. 20 to the General Corporation Law of 1890 ch. 563. It was amended by L. 1901 ch. 355.

³Sec. 50 Stock Corporation Law. "* * * This section shall not apply to a banking corporation." Amended by L. 1925 ch. 120 in effect March 12, 1925. Amendment added above sentence at the end of section.

⁴The voting trust agreement provides for the deposit by stockholders of the Bank of their shares of stock with the individual defendants as trustees and their successors and the issuance by the trustee in exchange therefor of trust certificates.

⁵The following states have neither statutes nor judicial decisions concerning voting trust agreements: Arizona, Arkansas, Colorado (see *People ex Rel. Arkansas Valley v. Burke* 72 Col. 486, 212 Pac. 837, 842, 1923), Idaho, Indiana, Iowa, Kansas, Louisiana, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, New Mexico, Oklahoma, Oregon, South Carolina, South Dakota, Tennessee, Texas, West Virginia, Wisconsin, Wyoming.

The following states have statutes validating voting trust agreements: Delaware, Corporation Law amended April 2, 1925 sec. 18; Maryland, Bagby Annotated Code p. 582 sec. 102; Nevada, chap. 177 Law of 1925; New York, *supra*, note 2; Rhode Island, Laws of Rhode Island, Revision of 1923, p. 987, by reference and implication; Florida, Cum. Stat. 1925, sec. 4120 (19) p. 782.

The following states have judicial decisions validating voting trusts in some form or other: Alabama, *Mobile & Ohio R. R. v. Nicholas*, 98 Ala. 92, 12 So. 723 (1893); California, *Smith v. S. F. & N. P. Ry.*, 115 Cal. 584, 47 Pac. 582 (1897); Kentucky, *Ecker v. Kentucky Refining Co.*, 144 Ky. 264,

The early authorities were inclined to condemn per se all agreements which attempted to tie up a majority of the stock of a corporation and frowned upon any voting trust or pooling agreement as void as against public policy.⁶ But, wherever public policy is mentioned it may not be amiss to quote the trenchant observations of a distinguished English judge, Burrough J., "I, for one, protest, as my Lord has done, against arguing too strongly upon public policy;—it is a very unruly horse and when once you get astride it you never know where it will carry you. It may lead you from sound law. It is never argued at all but where other points fail."⁷

The preponderant opinion stressed by the early authorities and decisions⁸ and the vitally important role they played grows out of the clearness and force with which they announced the doctrine, that each stockholder owes to his fellow stockholders a duty in regard to the voting of his stockholdings and that the law will take cognizance of this duty at least to the extent of not permitting a stockholder to irrevocably strip himself for any period of the power to fulfill it. In short, the power to vote is inherently annexed to and inseparable from each share and in each case the basis for the decision is that every stockholder *must be free to cast his vote* for what he deems the best interest of the corporation; the other stockholders being entitled to the benefit of such free exercise of his judgment each by each, and the recogni-

138 S. W. 264 (1911); Maine, *Hall v. Merrill Trust Co.*, 106 Me. 465, 76 Atl. 926 (1910); Massachusetts, *Bullivant v. First National Bank*, 246 Mass. 324, 141 N. E. 41 (1923); New Hampshire, *Bowditch v. Jackson*, 76 N. H. 351, 82 Atl. 1014 (1912); North Dakota, *Gage v. Fischer*, 5 N. D. 297, 65 N. W. 809 (1895); Ohio, *Griffith v. Jewett*, 15 L. B. W. 419 (1886), modified in *Craig v. The Besie Furnace Co.*, 19 Nisi Prius (N. S.) 545 (1917); Pennsylvania, *Boyer v. Nesbitt*, 76 Atl. 103 (1910); Utah, *White v. Snell*, 35 Utah 434, 100 Pac. 927 (1909); Vermont, *Thompson Starrett v. Ellis*, 86 Vt. 282, 84 Atl. 1017 (1912); Virginia, *Carnegie Trust Co. v. Security Life Ins. Co.*, 111 Va. 1, 68 S. E. 412 (1910); Washington, *Clark v. Foster*, 98 Wash. 241, 167 Pac. 909 (1911). The earliest case trenching on the subject is *Brown v. Pacific Mail S. S.*, 5 Blatch. 525 (S. D. N. Y. 1867).

The following states have judicial decisions prohibiting voting trust agreements: Connecticut, *Shepaug Voting Trust Cases*, 60 Conn. 553, 24 Atl. 32 (1890); Georgia, *Morel v. Hodge*, 130 Ga. 625, 61 S. E. 487 (1908); Illinois, *Luthy v. Ream*, 270 Ill., 170, 110 N. E. 373 (1915); North Carolina, *Harvey v. Linville Imp. Co.*, 118 N. C. 693, 24 S. E. 489 (1896); New Jersey, *Warren v. Pim*; 66 N. J. Eq. 353, 59 Atl. 773 (1904).

This note does not include testamentary voting trusts. Cf. *Billings v. Marshall Furnace Co.*, 210 Mich. 1, 177 N. W. 222 (1920); contra: *Re Pittock's Will*, 102 Or. 159, 199 Pac. 633 (1921).

⁶ *Shepaug Voting Trust Cases*, 60 Conn. 553, 24 Atl. 32 (1890); *Cone v. Russel* 48 N. J. Eq. 208, 21 Atl. 847 (1891); *Harvey v. Linville Imp. Co.*, 118 N. C. 693, 24 S. E. 489 (1896).

⁷ *Richardson v. Mellish*, 2 Bing. C. P. 229, quoted by Gray, J. in *Converse v. Sharpe* 161 N. Y. 571, 56 N. E. 69 (1900).

⁸ *Baldwin, Voting Trusts* (1892) 1 Yale L. J. 1; *Smith, Validity of Voting Trusts* (1922) 22 Col. L. Rev. 627; *Supra*, note 6.

tion that the self interest of the stockholders will furnish the only available guaranty that the stock will be voted in the interest of the corporation.

While this rule admits its exceptions⁹ it is nevertheless the rule and accordingly, except within its limitations, voting trusts are held contrary to public policy and void.

The suggestion that the use of the word "trust" is a cause for the early indictment of voting trust agreements is not without force and the trend of latter decisions is to uphold the validity of voting trust agreements wherever the propriety of their objects and the good purpose of their creation affirmatively appear. The voting trust should not be condemned per se. The validity of the agreement should be made dependent upon the purposes for which the trust is created, the powers conferred, and the propriety of the objects in view.

The contrary view holds it unsound to claim that "all agreements and devices by which the stockholders surrender their voting powers are invalid." It is unsound to hold that voting trust agreements are void per se, as opposed to good policy. The correct rule should be to uphold the legality of the voting trust, provided the propriety and reasonableness of its objects affirmatively appear, and provided that the arrangement itself is honest and equitable. The trust should only be condemned in those instances where the trust is created and carried out in order to effectuate an improper, unjust, or monopolistic object.¹⁰

The minority view apparently is the more progressive and is cognizant of the trend of economic advance, but, while based upon the expression of opinion in some of the later adjudications,¹¹ it seems to be only a compromise with the prevailing opinion based upon its exceptions.

The voting trust is a mere contract and as a form of contract it can hardly be said that because contracts have been used for the

⁹ A separation of the voting power of stock from its real or beneficial ownership, irrevocable for a fixed period is contrary to public policy and void unless: (1) It is coupled with or to protect an interest; or (2) Made to carry into effect some determined plan or policy to which the voting trustee is bound; or (3) It is merely a pooling contract under which the real owners reserve the right to direct the voting trustee. This exception is limited to states where pooling contracts are sustained." Smith, *supra* note 8.

¹⁰ Wormser, *Legality of Corporate Voting Trusts* (1918) 18 Col. L. Rev. 123. 2 Machen, *Modern Law of Corporations*, (1908) sec. 1269; 3 Cook, *Corporations*, (8th Ed. 1923) sec. 622; 3 Fletcher, *Corporations* (1917) sec. 1705; Cushing, *Voting Trusts* (1915) chap. 3.

¹¹ *Ecker v. Kentucky Refining Co.*, 144 Ky. 264, 138 S. W. 264 (1911); *Clark v. Foster*, 98 Wash. 241, 165 Pac. 909 (1917); *White v. Snell*, 35 Utah 434, 100 Pac. 927 (1909); *Frost v. Carse*, 91 N. J. Eq. 124 (1919). The latter case seems to have the effect of crystallizing the rule and if the purpose is in accordance with the views as to commercial rectitude entertained by the court, the voting trust is valid, otherwise it is void absolutely.

purpose of perpetrating frauds that all contracts are therefore suspicious. If there is any fraud in connection with the execution of a voting trust agreement, the remedies against fraud are or should be sufficient protection to any defrauded party. Should any hardship result from the operation of a voting trust agreement which was not in contemplation of the parties at the time of the making, is it any different from what may arise from the results of the operation of any ordinary contract? Why should a man be released from such an agreement any more than from any other type of contract because of unforeseen results and difficulties?¹² Further, to hold as some cases have indicated, that a voting trust is valid only with respect to original subscribers,¹³ and that it cannot be enforced against purchasers holding under the original subscribers, whether with or without notice, is to take the backbone out of the agreement. For, whenever a man parts with rights under a contract, he cannot retake these rights and recover his status quo by alienating any interest in the transaction that he may have.

It is not the purpose of the voting trust agreement which the court should scrutinize, but rather the actions of the trustees and subscribers thereto.¹⁴

The apparent fallacy in the minority view is discernible when it is considered that at the same time anything which can be done by the majority of stockholders acting through a trustee can equally well be done by their acting in unison without the interposition of a trustee or a voting trust agreement. Is the trustee in a better position to pilfer the corporation because of a trust agreement than the majority stockholders are before the execution of a trust agreement? On the contrary may it not be presumed that because of the trustee's fiduciary relationship the logical criterion should be to recognize the validity of his appointment but scrutinize his actions?

Legislative sanction is undoubtedly the best recognition of this bit of corporate mechanism.¹⁵ In the larger corporations especially, a concentrated voting power, invariably essential to the corporate existence, is impossible except by such devices. The wide diffusion of voting power and its vices becomes distinct and detrimental in expansion and reorganization policies. Voting trusts have continually been used to effect such situations with success.¹⁶ In fact, is not every close cor-

¹² *Cottrell v. Smokeless Fuel Co.*, 148 Fed. 594 (C. C. A. 4th 1906); *Mathews v. American Cent. Ins. Co.*, 154 N. Y. 449, 48 N. E. 751 (1897); 3 *Williston* (1924), 3337.

¹³ *White v. Thomas Inflatable Tire Co.*, 52 N. J. Eq. 178, 28 Atl. 75 (1893).

¹⁴ *Finkelstein, Voting Trust Agreements* (1926) 24 Mich. L. Rev. 324.

¹⁵ *Supra*, note 5.

¹⁶ 3 *Dewing, Financial Policy of Corporations*, (1920) 146; *Daggert, Railroad Reorganization* (1908) form, *Gerstenberg, Material of Corporate Finance* (4th ed. 1922) 91, 966; see also *International Harvester Co. voting trust agreement in reorganization policy. Dewing Financial Policy of Corporation* (2nd ed. 1926) 617.

poration a voting trust? And, while the voting trust agreement is not without its dangers, the very concentration of powers granted by it has rarely been abused.

The increasingly constant use of voting trust agreements in the present day trend of business suggests their necessity and "whatever methods may be devised by lawyers or by business men for the adequate protection of their interests, should not be frowned upon by the courts for no better reason than some supposed 'public policy' is infringed. This is a situation which must be governed by rules rather than by standards of law. Considerations of public policy in such cases are best left to the legislature."¹⁷

However, it has been the general policy of organized governments to treat the function of banking as one in which the public has a direct interest.¹⁸ Banking corporations have been set apart and distinguished by certain specific requirements as to the manner of organization, disability against issuing non-voting stock, the qualifications, duties, and liabilities of share-holders, directors and other officers, etc., in fact, the mere enactment of the Banking Law conclusively indicates the intention of the Legislature to classify banking corporations as distinct from ordinary business corporations and as quasi public in character. Thus, in lieu of their fiduciary relationship in regard to the public the principle case¹⁹ raises an interesting point in whether or not a bank could validly enter into a voting trust agreement prior to enactment of the amendment of March 1925, without contravening a previous statute.²⁰ This statute, passed nine years prior to sec. 50 of the Stock Corporation law, prohibits the issuance of a mere proxy of bank stock to bank officers for any meeting, and accordingly the learned judge²¹ in the lower court held a fortiori irrevocable authority to bank directors to vote stock over a period of ten years, under a naked trust, must in reality transgress the legislative declaration of policy inasmuch as bank directors are officers within the meaning of the statute.²²

The Appellate Division²³ reversed this holding, saying that in so

¹⁷ *Supra*, note 14.

¹⁸ *Gause v. Commonwealth Trust Co.*, 196 N. Y. 134, 89 N. E. 476 (1909). *Craughwell v. Mousam River Trust Co.*, 113 Me. 531, 95 Atl. 221 (1915).

¹⁹ *Supra*, note 1.

²⁰ Sec. 26, General Corporation Law, in part. "No officer, clerk, teller or bookkeeper of a corporation formed under or subject to the banking law shall act as proxy for any stockholder at any meeting of such corporation." Derived from L. 1892 ch. 687 which added a new section 21 to the General Corporation Law. Sec. 26 of the General Corporation Law of 1890, ch. 563, "When to take effect," was omitted from L. 1892 ch. 687. Now 332.

²¹ *Proskauer, J.* 214 N. Y. Supp. 643-647 (Sup. Ct. 1926).

²² *Eastham v. New York State Telephone Co.*, 86 App. Div. 563 (3d Dept. 1903); *Torbett v. Eaton*, 113 N. Y. 623, 20 N. E. 876 (1889); 2 Op. Atty. Genl. N. Y. (1912) 285.

²³ *Martin, J.* 217 N. Y. Sup. 67 (App. Div. 1926). This ruling, that the amendment was not retroactive in effect, obviated a holding on an interest-

ruling the court below had disregarded essential differences between a voting trust and a proxy.²⁴ Therefore if the theory that a trust is nothing more than a collective proxy and revocable as such is good, then "the many statutes limiting the effective duration of a proxy would also operate to render totally ineffective a voting trust." To this doctrine the higher court refused to adhere.

Ultimately the case will appear before the Court of Appeals and whether that court will agree with the learned opinion of the *Nisi Prius* court in holding that a bank voting trust is essentially against public interest and that therefore the statute should be interpreted as positively prohibiting such agreements or whether the Appellate Division was correct in ruling that the creation of a voting trust agreement among stockholders of a bank does not contravene public policy and therefore should be permitted except as absolutely prohibited by statute, is the precise question.

The only case holding on the subject is the case of *Bridgers v. First National Bank*,²⁵ but this case may be regarded as dubious authority inasmuch as it was decided in a state which holds such agreements void per se.

The basis for the decision of the Court of Appeals will rest upon public policy and it seems that such agreements in banks must be regarded as abhorrent to public interest and therefore void per se. Voting trust agreements in banks are to be placed in the first subdivision mentioned, and the amendment to the statute takes such agreements outside the limitations.

M. H.

RECOGNITION OF FOREIGN DIVORCES IN NEW YORK—In a late case,¹ the facts were: the plaintiff and defendant were residents of, and married, in Canada. Defendant subsequently abandoned his wife in Canada and came to live in Pennsylvania, where after falsely testifying that he did not know the whereabouts of his wife and securing service of summons by publication, he obtained a decree of divorce. Subsequent to this action, the plaintiff moved to New York and established her domicile there. The defendant remarried and came to New York to live. Plaintiff thereupon sued for divorce. Defendant set up Pennsylvania decree as bar to action. Held—defense was untenable and Pennsylvania decree was not a bar to the action.

ing point as to the constitutionality of a provision which would effect vested and inchoate rights, created by contract according to a provision in the agreement "any stockholder may become a party to this agreement."

²⁴ Cushing, *Voting Trusts* (1915) 124; 3 *Fletcher, Corporations* (1917) 2873.

²⁵ 152 N. C. 293, 67 S. E. 770 (1910). In this case a national bank was involved. The facts are on all fours with the principal case and the proxy statute in question was Rev. St. sec. 5144 (U. S. Comp. St. 1901 p. 3464).

¹ *Dean v. Dean*, 241 N. Y. 240 (1926).