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I. INTRODUCTION

Cumulative voting for corporation directors is a system intended to allow *minority* shareholders to elect some of the directors of their corporation.[1] Representation on the board of directors is important because the board of directors manages the corporation and establishes its policies.[2]

The other method of voting for directors is sometimes called "straight" voting. With straight voting, majority shareholders can usually elect *all* of the directors of their corporation, while the minority shareholders can elect *none*.[3] In contrast, cumulative voting for directors is intended to allow minority shareholders to elect a number of directors which is in rough proportion to their voting strength.[4] The operation of these two methods of

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1. *E.g.*, Roanoke Agency, Inc. v. Edgar, 101 Ill. 2d 315, 318, 461 N.E.2d 1365, 1367 (1984) ("[C]umulative voting was designed to enable minority stockholders of a corporation to gain representation on its board of directors in proportion to their voting strength").

2. Section 8.01(b) of the Revised Model Business Corporation Act provides, "All corporate powers shall be exercised by or under the authority of, and the business and affairs of the corporation managed under the direction of, its board of directors, subject to any limitation set forth in the articles of incorporation." REVISED MODEL BUSINESS CORP. ACT § 8.01(b) (1988).

3. *E.g.*, Givens v. Spencer, 232 Ga. 806, 209 S.E.2d 157 (1974).

4. *Id.* There is a difference of opinion whether the right to use cumulative voting guarantees minority shareholders representation on the board of directors in rough proportion to their share holdings, or whether it merely gives minority shareholders the right to vote cumulatively, but with no guarantee as to results. *Compare* Wolfson v. Avery, 6 Ill. 2d 78, 93-95, 126 N.E.2d 701, 710-11 (1955) (classification of directors illegal where such would deprive minority shareholder of proportional representation) *with* Humphrys v. Winous Co., 165 Ohio St. 45, 59, 133 N.E.2d 780, 789 (1956) (cumulative voting "guarantees to minority shareholders only the right of cumulative voting and does not necessarily guarantee the effectiveness of the exercise of that right").

voting for corporation directors, *straight voting* and *cumulative voting*, has been summarized in the following manner:

> Under straight voting each shareholder votes the number of shares he owns for as many candidates as may be elected. If two directors are to be elected, the shareholder may vote the number of shares he owns for each of the two candidates. *Under this procedure, the man who owns a majority of the shares can elect the entire board of directors. Under cumulative voting, which is a procedure designed to give some control to minority shareholders*, each shareholder gets a block of votes equal to the number of shares he owns multiplied by the number of directors to be elected. The shareholder may then cast his entire block for one candidate or may distribute his votes among any number of candidates in whatever proportion he desires.[5]

Majority shareholders may favor the use of straight voting for the obvious reason that straight voting allows them to elect all of the directors.[6] Minority shareholders, on the other hand, may favor the use of cumulative voting for the equally obvious reason that cumulative voting allows them to elect some, although not a majority, of the directors.[7]

In most corporations the voting power of majority shareholders allows them to decide whether to use cumulative or straight voting or, if cumulative voting is required by statute or constitutional provision, to control its effectiveness.[8] Thus, although the concept of cumulative voting superficially appears to give minority shareholders protection from the voting power of the majority, that "protection" is illusory because the cumulative voting system is subject to majority shareholder control. In reality, minority shareholders get no real protection from a cumulative voting system which is controlled by their adversaries, the majority shareholders, just like hens get no real protection when their hen house is controlled by their adversary, the fox.

In most corporations, minority shareholders can do little

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5. *Givens*, 232 Ga. at 806, 209 S.E.2d at 157 (emphasis added).

6. *E.g.*, Steadman & Gibson, *Should Cumulative Voting For Directors Be Mandatory?— A Debate*, 11 BUS. L. 9, 12 (1955) ("A majority of the shareholders that can elect all the directors by straight voting can hardly be expected to adopt a method of electing directors which would give them something less.").

7. *E.g.*, N. LATTIN, THE LAW OF CORPORATIONS § 91 (2d ed. 1971).

8. The various ways in which the majority shareholders can use their voting power to control the use or effectiveness of cumulative voting are discussed in Part III. *See infra* text accompanying notes 27-91.

more than plead with majority shareholders to implement cumulative voting, which is like the hens pleading with the fox for protection.[9] This paradox, that in most corporations the majority shareholders control the use or effectiveness of a system (cumulative voting) which is intended as a limitation on their power, is the focus of this article. Part II of this article provides an overview of the manner in which the straight voting and cumulative voting systems operate. Part III shows the tactics by which majority shareholders may use their voting power to eliminate or avoid cumulative voting, or to minimize its impact. Part IV is a summary. Part V explains why state legislatures are unwilling to eliminate the avoidance tactics used by the majority shareholders and enforce the use of cumulative voting (assuming they agree with it in principle). Part VI concludes that national rules are the most effective means of safeguarding minority shareholders and of implementing the use of cumulative voting. And last, Part VII is a conclusion.

II. Straight Voting and Cumulative Voting

A. Straight Voting

To understand cumulative voting for corporation directors and the tactics used by majority shareholders in opposition to it, one must first understand traditional "straight" voting. Assume a corporation which has six directors, the majority shareholders have 1000 shares, the minority shareholders have 550 shares, and each share is entitled to one vote.[10] With six directors to be elected, the majority shareholders may propose six candidates (candidates A, B, C, D, E and F), and the minority shareholders may propose six candidates (candidates U, V, W, X, Y and Z).

The candidacy of each potential director is a separate matter on which the shareholders are entitled to vote.[11] Voting for

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9. Professor Lattin claims that management will usually oppose the implementation of cumulative voting: "Management is usually opposed to cumulative voting and in practically every case where a shareholder's proposal is presented to acquire this privilege, management recommends that shareholders not vote for it." N. Lattin, *supra* note 7, § 91, at 374.

10. *E.g.*, 5 W. Fletcher, Fletcher Cyclopedia of the Law of Private Corporations § 2045.1 (rev. vol. 1987) ("As a general rule, fractional shares of stock cannot be voted in the absence of express statutory authority"). For an example of the complications caused when fractional shares of stock are voted cumulatively, see Garnier v. Garnier, 248 Cal. App. 2d 255, 56 Cal. Rptr. 247 (1967).

11. *E.g.*, Givens v. Spencer, 232 Ga. 806, 209 S.E.2d 157 (1974) ("Under straight voting each shareholder votes the number of shares he owns for as many candidates as

these candidates is by its nature an election in which the shareholders vote for, but not against, a candidate.[12] The majority shareholders may vote their 1000 votes separately for each candidate they favor, and the minority shareholders may vote their 550 votes separately for each candidate they favor.[13] The result would usually be as follows:

Table 1: Straight Voting

Votes Cast by the Majority Shareholders:		Votes Cast by the Minority Shareholders:
1000	A	0
1000	B	0
1000	C	0
1000	D	0
1000	E	0
1000	F	0
0	U	550
0	V	550
0	W	550
0	X	550
0	Y	550
0	Z	550

When the voting is finished, the six candidates with the greatest number of votes (a plurality) will be elected.[14] Here, the majority shareholders will elect all six of their candidates (A, B, C, D, E and F) as directors of the corporation and the minority shareholders will elect none of their candidates. So long as the majority shareholders remain able to cast one more vote than the minority shareholders, the majority shareholders will continue to elect *all* of the directors and the minority shareholders will elect *none*.[15]

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may be elected.").

12. *E.g.*, Stancil v. Bruce Stancil Refrigeration, Inc., 81 N.C. App. 567, 570, 344 S.E.2d 789, 791 (1986) ("There is no provision in the North Carolina Business Corporation Act providing for the casting of shareholder votes against a nominee for director").

13. *E.g.*, *Givens*, 232 Ga. at 806, 209 S.E.2d at 157.

14. Section 7.28(a) of the Revised Model Business Corporation Act provides: "Unless otherwise provided in the articles of incorporation, directors are elected by a plurality of the votes cast by the shares entitled to vote in the election at a meeting at which a quorum is present." REVISED MODEL BUSINESS CORP. ACT § 7.28(a) (1988).

15. N. LATTIN, *supra* note 7, § 91, at 375 ("Without [cumulative voting], even a group holding 49% of the voting shares could not elect a single director").

B. Cumulative Voting

The cumulative voting system is a reaction to the one-sided results of straight voting.[16] In general, cumulative voting applies to the election of directors[17] in profit-seeking corporations with outstanding stock,[18] which are subject to the general corporation law of the state of incorporation.[19] The original idea for cumulative voting came from political theories, where the ideal was that majority and minority electors should all be represented in proportion to their numbers.[20] The first expression of those political ideas in corporation law was the 1870 Illinois Constitution.[21]

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16. In a speech given in 1893, John H. Doyle, then president of the Ohio State Bar Association, argued as follows in favor of cumulative voting:

> The old story, so often told, of a prominent Eastern newspaperman's reply to the question of what the shares in his company were worth, is very apt: "There are 51 shares," said he, "that are worth $250,000. There are 49 shares that are not worth a ——." I think the law should be so amended as to allow the 49 shares to elect two out of the five directors or three out of seven, as the case may be. In other words, that the shareholders be allowed to cumulate their votes on one or more directors, as they see fit, so that all interests may be fairly represented, without destroying the right of the majority to control.

Address by John H. Doyle before the annual meeting of the Ohio State Bar Association at Put-in-Bay, Ohio (July 1893) (*quoted in* Humphrys v. Winous Co., 165 Ohio St. 45, 50, 133 N.E.2d 780, 783 (1956)).

17. *See* Bridgers v. Staton, 150 N.C. 216, 220, 63 S.E. 892, 894 (1909) (cumulative voting does not apply to motions to adjourn).

18. Cumulative voting does not apply to non-profit corporations which have no stock. *See* Farmers No. 4, Inc. v. Lexington Tobacco Bd. of Trade, 461 S.W.2d 926, 929-30 (Ky. 1970) (cumulative voting not applicable to non-profit corporation with a board of directors but no stock); Westlake Hosp. Ass'n v. Blix, 13 Ill. 2d 183, 196, 148 N.E.2d 471, 479 (1958) (cumulative voting not applicable to non-profit corporation with a board of directors, but no stock); American Aberdeen-Angus Breeders' Ass'n v. Fullerton, 325 Ill. 323, 327, 156 N.E. 314, 316 (1927) (cumulative voting not applicable to non-profit corporation with a board of directors, but no stock). *But see* Commonwealth *ex rel.* MacCullum v. Acker 308 Pa. 29, 162 A. 159 (1932) (cumulative voting applicable to Presbyterian Ministers' Fund, which was a charitable organization without shareholders); Commonwealth *ex rel.* Eilenberger v. Yetter, 190 Pa. 488, 43 A. 226 (1899) (normal school operated as a corporation with trustees and shareholders is subject to cumulative voting).

19. Cumulative voting does not apply to corporations such as banks which are not organized under general corporation law. *See* Robertson v. State *ex rel.* Clement, 406 S.W.2d 90, 92 (Tex. App. 1966); State *ex rel.* Kearns v. Rindsfoos, 161 Ohio St. 60, 118 N.E.2d 138 (1954); Attorney Gen. *ex rel.* Hurley v. Bridgman, 134 Mich. 379, 96 N.W. 438 (1903).

20. *See* Comment, *Classified Boards in Missouri*, 32 Mo. L. Rev. 251, 252 n.8, 261 n.68 (1967) (credit for developing political theories related to minority representation should be shared by Thomas Gilpin, James Garth Marshall and John Stuart Mill).

21. Political philosophy relating to proportional representation was transplanted into the world of corporations as part of the politics of the 1870 Illinois constitutional convention. Joseph Medhill, a delegate to the convention and, not incidentally, publisher of the *Chicago Tribune*, introduced and advocated a constitutional provision imposing

Since 1870, the use of cumulative voting has grown to the point that, with the exception of Massachusetts and Wisconsin, all of the states and the District of Columbia now permit or require its use.[22]

Cumulative voting for corporate directors allows shareholders "to multiply the number of votes they are entitled to cast by the number of directors for whom they are entitled to vote and cast the product for a single candidate or distribute the product among two or more candidates."[23] Applying the cumulative voting provisions to the facts used previously, the majority shareholders have 6000 votes (1000 shares x 6 directors = 6000 votes), and the minority shareholders have 3300 votes (550 shares x 6 directors = 3300 votes). Those votes can be distributed among the candidates for director in whatever combinations the shareholders choose:

Table 2: Cumulative Voting
(columns represent separate voting strategies)

Votes Cast by the Majority Shareholders							Votes Cast by the Minority Shareholders						
6000	3000	2000	1500	1200	1000	A	0						
	3000	2000	1500	1200	1000	B	0						
		2000	1500	1200	1000	C	0						
			1500	1200	1000	D	0						
				1200	1000	E	0						
					1000	F	0						
					0	U	550	660	825	1100	1650	3300	
					0	V	550	660	825	1100	1650		
					0	W	550	660	825	1100			
					0	X	550	660	825				
					0	Y	550	660					
					0	Z	550						

Under the voting above, the minority shareholders will normally choose to vote for only two directors[24] (1650 votes each),

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mandatory cumulative voting for directors on Illinois corporations. Medhill's provision survived as section 3 of Article XI of the 1870 Illinois Constitution. Wolfson v. Avery, 6 Ill. 2d 78, 89-93, 126 N.E.2d 701, 708-10 (1955). *See also* C. WILLIAMS, CUMULATIVE VOTING FOR DIRECTORS, 20-25 (1951); Comment, *supra* note 20 at 261.

22. *See infra* notes 30-32 and accompanying text.

23. REVISED MODEL BUSINESS CORP. ACT § 7.28(c) (1988).

24. The following formula shows the number of votes necessary to elect a given

since no matter how the majority votes, the two minority candidates will be among the top six in numbers of votes received, and will be elected.[25] Voting for and electing two directors gives the minority shareholders representation on the board of directors in rough proportion to their stock holdings.[26]

III. Tactics Affecting the Use of Cumulative Voting

As shown above, cumulative voting may be used to provide minority shareholders representation on a board of directors in rough proportion to their stock holdings. There are, however, tactics which can be employed by majority shareholders to eliminate, avoid, or minimize the impact of cumulative voting.[27] In summary, those tactics include the following:

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number of directors and tells minority shareholders how to allocate their cumulated votes.

$$X = \frac{Y \times N^1}{N + 1} + 1$$

X = The number of shares necessary to elect a given number directors.
Y = The number of shares to be voted at the meeting.
N^1 = The number of directors desired to be elected.
N = The total number of directors to be elected.

Cole, *Legal and Mathematical Aspects of Cumulative Voting*, 2 S.C.L. Rev. 225 (1950); Gerstenberg, *The Mathematics of Cumulative Voting*, 9 J. Acct. 177 (1910); Mills, *The Mathematics of Cumulative Voting*, 1968 Duke L.J. 28. *Cf.* Glazer, Glazer & Grofman, *Cumulative Voting in Corporate Elections: Introducing Strategy into the Equation*, 35 S.C.L. Rev. 295 (1984) (examples are given wherein the formula above may be "flawed" and alternative ways of calculating voting strategies are suggested).

Application of the formula above to the facts used in Table 2 shows that 444 votes are necessary to elect two directors and 666 votes are required to elect three directors. With 550 votes, the minority shareholders should vote for two directors.

25. *See supra* note 14. If there is a tie among the candidates, a runoff election is held. Wright v. Commonwealth, 109 Pa. 560, 1 A. 794 (1885) (five candidates received a plurality in voting to fill seven positions on the board, with deadlock between three candidates for the remaining two positions; a further ballot was ordered to break the deadlock, if possible). The right to vote cumulatively extends to all ballots and not just the first. State *ex rel.* Price v. Du Brul, 100 Ohio St. 126 N.E. 87 (1919).

26. The minority shareholders hold 35% of the stock and elect 33% of the directors.

27. Not all tactics in opposition to cumulative voting are successful. *See, e.g.*, Commonwealth *ex rel.* Brant v. Garrett Water Co., 41 Pa. D. & C. 357 (C.P. 1941) (a bylaw prohibiting cumulative voting was held to violate a constitutional mandatory cumulative voting provision); Wright v. Central Cal. Colony Water Co., 67 Cal. 532, 8 P. 70 (1885) (a bylaw requirement that a separate election be held with respect to the candidacy of each person who would be a director was held to violate the right to vote cumulatively); People *ex rel.* Snapp v. Younger, 238 Ill. App. 502 (1925) (a bylaw that no person could own or vote more than eight shares was held to violate that state's mandatory cumulative voting requirements); Durkee v. People *ex rel.* Askren, 155 Ill. 354, 40 N.E. 626 (1895) (a bylaw provision that allowed bondholders to vote was held to violate the right of shareholders to vote cumulatively); Tomlin v. Farmers & Merchants Bank, 52 Mo. App. 430

A. Most states have cumulative voting provisions which are "permissive" and not "mandatory," meaning that the decision to use cumulative voting is made at the corporation level. Majority shareholders usually control this decision and thereby control the use of cumulative voting.

B. "Mandatory" cumulative voting cannot be imposed on a corporation which was incorporated before mandatory cumulative voting was made part of the corporation law, if doing such violates the contract clause of the United States Constitution.

C. Majority shareholders can avoid "mandatory" cumulative voting by incorporating in a state using "permissive" cumulative voting and then causing their corporation to do business in the "mandatory" state as a foreign corporation.

D. If majority shareholders cannot avoid cumulative voting outright, they may nevertheless eliminate or minimize the ability of minority shareholders to elect directors by:

1) reducing the total number of directors of the corporation;
2) using classes of directors or shareholders;
3) using unequal voting rights for shareholders; or,
4) removing minority directors without cause.

Each of these tactics is discussed hereafter.

A. "Mandatory" and "Permissive" Statutes and Constitutional Provisions

There is no common law right to use cumulative voting, it exists only where authorized by state law.[28] Twelve states have constitutional or statutory provisions which require all corporations subject to their general corporation laws[29] to use cumulative voting.[30] These provisions are "mandatory" because no dis-

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(1892) (a resolution by majority shareholders that each share receive one vote was held to violate the right of shareholders to vote cumulatively).

28. *E.g.*, *In Re* Brophy, 13 N.J. Misc. 462, 179 A. 128, 129 (1935) ("There was no common-law right to cumulative voting; it exists only by virtue of the statute, and may be exercised only in accordance with the statute."); Standard Scale & Supply Corp., v. Chappel, 16 Del. Ch. 331, 141 A. 191 (1928).

29. *See supra* note 18-19 and accompanying text.

30. ARIZ. CONST. art. XIV, § 10; ARIZ. REV. STAT. ANN. § 10-033 1977); CAL. CORP. CODE § 708 (West Supp. 1989); HAWAII REV. STAT. § 415-33 (1985); KY. CONST. § 207; KY. REV. STAT. §271B.7-280 (Michie/Bobbs-Merrill Supp. 1988); MO. CONST. art. XI, § 6 (amended 1988 to allow cumulative voting); MO. ANN. STAT. § 351.245 (Vernon Supp. 1989); MONT. CONST. art. m, § 4; MONT. CODE ANN. § 35-1-506 (1987); NEB. REV. STAT. § 21-2033 (1987); N.C. GEN. STAT. § 55-67 (1982 & Supp. 1989); N.D. CONST. art. XII, § 6; N.D. CENT. CODE § 10-19.1-39 (1985); S.D. CONST. art. XVII, § 5; S.D. CODIFIED LAWS ANN. § 47-5-6 (1983); W. VA. CODE § 31-1-93 (1988); WYO. STAT. § 17-1-130 (1987).

cretion is allowed at the corporation level regarding the use of cumulative voting.

In ten states, cumulative voting is used unless it is excluded in the articles of incorporation or the bylaws.[31] In twenty-six states and the District of Columbia cumulative voting is not used unless it is authorized in the articles of incorporation.[32] The provisions in these states and the District of Columbia are "permissive" because the decision to use cumulative voting is made at the corporation level.

A review of cumulative voting provisions shows a trend toward the adoption of permissive provisions, and away from mandatory provisions.[33] In 1937, seventeen states and the Territory of Alaska had mandatory provisions, while fifteen states had permissive provisions. However, in 1989, only twelve states had mandatory provisions, and the number of jurisdictions with permissive provisions had risen to thirty-six states and the District of Columbia.[34] (Massachusetts and Wisconsin have no cumulative voting provisions.)

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31. ALASKA STAT. § 10.05.162 (1962); COLO. REV. STAT. §§ 7-2-102 & 7-4-116(4) (1986); IDAHO CONST. art. 11, § 4; IDAHO CODE § 30-1-33 (1980); ILL. ANN. STAT. ch. 32 paragraph 7.40 (Smith-Hurd 1985); MINN. STAT. ANN. § 302A.215 (West 1985); MISS. CODE ANN. § 79-4-7.28(b) (Supp. 1989); Ohio Rev. Code Ann. § 1701.55 (Anderson, 1985); S.C. CODE ANN. § 33-7-280 (Law. Co-op. Supp. 1988); TEX. REV. CIV. STAT. ANN. vol. 3A art. 2.29 (Vernon 1980 & Supp. 1984); WASH. REV. CODE ANN. § 23A.08.300 (1969).

32. ALA. CODE § 10-2A-53 (1987); ARK. STAT. ANN. § 4-27-728 (Supp. 1987); CONN. GEN. STAT. ANN. § 33-325 (West 1987); DEL. CODE ANN. tit. 8, § 214, 216 (1983 & Supp. 1988); D.C. CODE ANN. § 29-327 (1981); FLA. STAT. ANN. § 607.097 (West 1977); GA. CODE ANN. § 14-2-117 (1982); IND. CODE ANN. § 23-1-30-9 (Burns Supp. 1989); IOWA CODE ANN. § 496A.32 (West Supp. 1989); KAN. STAT. ANN § 17-6504 (1988); LA. REV. STAT. ANN. § 12:75 (West 1969 & Supp. 1989); ME. REV. STAT. ANN. tit. 13-A, § 622 (1981 & Supp. 1988); MD. CORPS. & ASS'NS CODE ANN. § 2-104 (1985); MICH. COMP. LAWS § 450.1451 (West 1973); NEV. REV. STAT. § 78.360 (1987); N.H. REV. STAT. ANN. § 293-A:33 (1987); N.J. STAT. ANN. 14A:5-24 (West Supp. 1989); N.M. STAT. ANN. § 53-11-33 (1983); N.Y. BUS. CORP. LAW § 618 (McKinney 1986); OKLA. STAT. ANN. tit. 18, § 1059 (West 1986); ORE. REV. STAT. § 57.170 (1984) (repealed by 1987 Ch. 52 § 181 § 60.251 (1987); 15 PA. CONS. STAT. ANN. § 1758(c) (Purdon Supp. 1989) (found in renumbered pamphlet issued in 1989); R.I. GEN. LAWS § 7-1.1-31 (1985); TENN. CODE ANN. § 48-17-209 (1988); UTAH CODE ANN. § 16-10-31 (1987); VT. STAT. ANN. tit. 11 § 1879 (1984); VA. CODE ANN. § 13.1-669 (1989).

33. *Cf. infra* note 98 (many states have abandoned mandatory cumulative voting to attract new incorporation).

34. *Compare supra* notes 30-32 *with* Bhagat & Brickley, *Cumulative Voting: The Value of Minority Shareholder Voting Rights*, 27 J.L. & ECON. 339, 344 & n.16-18 (1984) (in 1984, 18 states had "mandatory" cumulative voting, 29 states had "permissive" cumulative voting and three states had no provision for cumulative voting); *and* Note, *The Conflict of Cumulative Voting and Staggered Directorships*, 24 U. CIN. L. REV. 560, 562 nn.3-5 (1955) (in 1955, 20 states had "mandatory" cumulative voting, 18 states had "permissive" cumulative voting and 10 states had no provision for cumulative voting); *and*

In the majority of states, where "permissive" cumulative voting provisions are in place, the majority shareholders control the use or non-use of cumulative voting if they control amendments to the articles of incorporation or bylaws.[35] In these jurisdictions the power of majority shareholders to control cumulative voting is a stark reality because courts have refused to examine the motives of those who vote to eliminate it.[36] As a consequence, if there are no special agreements to the contrary,[37] the minority shareholders in these thirty-seven "permissive" jurisdictions enjoy the right of cumulative voting only at the sufferance of the majority shareholders.

Bowes & De Bow, *Cumulative Voting at Elections of Directors of Corporations*, 21 MINN. L. REV. 351, 351-52 & nn.6-12 (1937) (in 1937, 17 states and the Territory of Alaska had "mandatory" cumulative voting and 15 states had "permissive" cumulative voting; Maine, North Carolina and Utah had hybrid arrangements for cumulative voting and the remaining 15 states had no provision for cumulative voting).

35. *E.g.*, REVISED MODEL BUSINESS CORP. ACT § 10.03(e)(1) (1988) (unless otherwise required, amendments to articles of incorporation must be approved by "a *majority* of the votes entitled to be cast"); *id.* § 10.20 (bylaws may be amended by the board of directors or the shareholders).

36. Treco, Inc. v. Land of Lincoln Sav. & Loan, 572 F. Supp. 1455, 1460 (N.D. Ill. 1983) *aff'd* 749 F.2d 374 (7th Cir. 1984) (business judgment rule applied: acting in good faith and without a corrupt motive, directors were not liable for their decision to amend corporation bylaws to eliminate cumulative voting); Maddock v. Vorclone Corp., 17 Del Ch. 39, 147 A. 255 (1929) (in the absence of fraud, equity will not prevent amendment of articles of incorporation to eliminate cumulative voting for the purpose of barring minority shareholders from representation on board of directors); Chicago Macaroni Mfg. Co. v. Boggiano, 202 Ill. 312, 67 N.E. 17 (1903) (the motives of a shareholder while voting cumulatively are not subject to inquiry or control).

37. Shareholders can contract with respect to their cumulative voting rights. *See* N.C. GEN. STAT. § 55-73 (1982) (mandatory cumulative voting right may be waived by contract); Walden Inv. Group v. Pier 67 Inc., 29 Wash. App. 28, 30-31, 627 P.2d 129, 131 (1981) (articles of incorporation classifying shareholders and affecting cumulative voting are an enforceable contract); Sensabaugh v. Polson Plywood Co., 135 Mont. 562, 342 P.2d 1064 (1959) (contract not to vote cumulatively is enforceable); E.K. Buck Retail Stores v. Harkert, 157 Neb. 867, 62 N.W.2d 288 (1954) (shareholder can contract with respect to voting of stock despite a constitutional right to cumulative voting); Thistlethwaite v. Thistlethwaite, 200 Misc. 64, 101 N.Y.S.2d 679 (N.Y. Sup. Ct. 1950) (agreement to vote stock to implement cumulative voting may be enforced); Orme v. Salt River Valley Water Users' Ass'n, 25 Ariz. 324, 217 P. 935 (1923) (shareholders may contract with respect to their voting rights including cumulative voting rights); State *ex rel.* Frank v. Swanger, 190 Mo. 561, 89 S.W. 872 (1905) (articles of incorporation which excluded holders of preferred stock from voting did not violate mandatory cumulative voting provision of Missouri constitution). *But see*, People *ex rel.* Arkansas Valley Sugar Beet & Irrigated Land Co. v. Burke, 72 Colo. 486, 212 P. 837 (1923) (statute provided for cumulative voting and contract cannot provide otherwise); Durkee v. People *ex rel.* Askren, 155 Ill. 354, 40 N.E. 626 (1895) (contracts giving bondholders the right to vote were invalid in the face of statute giving the right to vote to shareholders).

B. Contract Clause

The contract clause of the United States Constitution[38] may provide an exception to the application of "mandatory" cumulative voting provisions, if those provisions were enacted *after* issuance of a corporate charter. A state creates a contract with a corporation and its shareholders when it approves a corporation charter.[39] Unless there is a reservation by the state of a power to amend the charter, or unless the corporation does an act subjecting it to the new corporation law, the state cannot "impair" its contract with the corporation and its shareholders by unilaterally imposing rules which conflict with the charter.[40]

Based on contract clause reasoning, many corporations have argued that mandatory cumulative voting provisions could not be applied to them because their charters were issued before mandatory cumulative voting became law. They have been successful if: (1) the charter was, in fact, issued before mandatory cumulative voting became law; (2) the corporation has not subsequently benefitted from the new general corporation law (of which mandatory cumulative voting is part) by an act such as amending their articles of incorporation; and (3) the general corporation law in effect at the time the charter was issued did not contain a reservation by the state of power to amend the rules under which the charter was issued.[41]

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38. U.S. CONST. art. I, § 10, cl. 1 ("No state shall . . . make any . . . law impairing the obligation of contracts").

39. Trustees of Dartmouth College v. Woodward, 17 U.S. (4 Wheat.) 518 (1819).

40. *Id.*

41. Golconda Mining Corp. v. Hecla Mining Co., 80 Wash. 2d 372, 494 P.2d 1365 (1972) (corporation renewed corporate charter under new corporation law and became subject to cumulative voting); Hanks v. Borelli, 2 Ariz. App. 589, 411 P.2d 27 (1966) (corporation renewed corporate charter under new corporation law and became subject to cumulative voting); State *ex rel.* Starky v. Alaska Airlines, Inc., 68 Wash. 2d 318, 328, 413 P.2d 352, 358 (1966) (constitution reserved power to amend corporation law, but that reservation did not apply to a corporation formed during territorial period); French v. Cumberland Bank & Trust Co., 194 Va. 475, 74 S.E.2d 265 (1953) (constitution reserved right to amend general corporation laws and statute allowing the abolition of cumulative voting was effective); Commonwealth *ex rel.* O'Shea v. Flannery, 203 Pa. 28, 52 A. 129 (1902) (corporation received benefits under new corporation law and thereby became subject to cumulative voting provisions of new law); Gregg v. Granby Mining & Smelting Co., 164 Mo. 616, 65 S.W. 312 (1901) (corporation subject to new cumulative voting law because charter contained reservation by state of power to amend corporation laws); Attorney Gen. *ex rel.* Dusenbury v. Looker, 11 Mich. 498, 69 N.W. 929 (1897) (constitution reserved right to amend corporation law and corporation was subject to new statute allowing cumulative voting); Commonwealth *ex rel.* Fernberger v. Butterworth, 160 Pa. 55, 28 A. 507 (1894) (corporation had not received any benefits under new corporation law and was not subject to new cumulative voting provision); Smith v. Atchison, T. & S.F.

Based on the same contract clause reasoning, some courts have also held that the state cannot unilaterally eliminate mandatory cumulative voting as a requirement for corporations which were incorporated during a time when mandatory cumulative voting was a requirement, if the shareholders of the corporation do not all agree.[42]

C. *Avoiding Mandatory State Statutes: Foreign Corporations and the California Experience*

State laws requiring mandatory cumulative voting have a significant achilles heel: a corporation may incorporate without cumulative voting in a state with *permissive* cumulative voting, but do business in a state with *mandatory* cumulative voting and thereby avoid cumulative voting.[43]

California is one of the fourteen states with a mandatory cumulative voting provision.[44] In 1976, in an attempt to prevent foreign corporations without cumulative voting provisions from doing business in California, the state legislature amended section 2115 of its corporations code to require foreign corporations to use cumulative voting for directors.[45] Section 2115, as amended, applies cumulative voting to a foreign corporation which generates more than fifty percent of its income in California, and with respect to which more than half of the shareholders have California addresses.[46] It does not apply to a corpora-

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R.R., 64 F. 272 (C.C.D. Kan. 1894) (corporation formed during territorial period not subject to reservation of powers in later constitution and not subject to later statute requiring cumulative voting); Cross v. West Virginia Cent. & P. Pa. Ry., 35 W.Va. 174, 12 S.E. 1071 (1891) (corporation subject to new cumulative voting law because charter contained reservation by state of power to amend corporation laws); Baker's Appeal 109 Pa. 461, 1 A.78, (1885) (corporation had not received any benefits under new corporation law and was not subject to new cumulative voting provision); Pierce v. Commonwealth, 104 Pa. 150 (1883) (railroad incorporated under act regulating railroad companies was subject to cumulative voting provision of general corporation law); Hays v. Commonwealth *ex rel.* McCutcheon, 82 Pa. 518 (1876) (corporation not subject to new cumulative voting provision).

42. Roanoke Agency Inc. v. Edgar, 101 Ill. 2d 315, 323-24, 461 N.E.2d 1365, 1369 (1984).

43. *See* Western Air Lines v. Sobieski, 191 Cal. App. 2d 399, 12 Cal. Rptr. 719 (1961).

44. *See supra* note 30 and accompanying text.

45. 1976 Cal. Legis. Serv., ch. 641, § 32.5, at 1674 (codified as amended CAL. CORP. CODE § 2115(b)) (West 1977).

46. CAL. CORP. CODE § 2115(a) (West 1977).

tion which has securities listed on a national securities exchange.[47]

The extent to which section 2115 can constitutionally be applied to foreign corporations is uncertain. In 1978, section 2115 was applied to Arden-Mayfair Inc., a Delaware corporation which was doing business in California but which had no provision for cumulative voting in its articles of incorporation or bylaws. The corporation had significant business contacts in states other than California, which led a California trial court to refuse to enforce section 2115 against Arden-Mayfair because section 2115 was unconstitutional "under the concepts contained in the full faith and credit and the commerce clauses of the Constitution of the United States, with special emphasis on the latter."[48]

On the other hand, in 1983, section 2115 (and cumulative voting) was applied to Louisiana-Pacific Resources, Inc., a Utah corporation which, like Arden-Mayfair, had no cumulative voting provision in its articles or bylaws. Louisiana-Pacific had virtually no business connections with the state of incorporation (Utah), did a majority of its business in California, and over fifty percent of its voting shareholders resided in California. On these facts, a California appellate court upheld the application of section 2115 (and mandatory cumulative voting), turning aside claims that this violated various constitutional requirements.[49]

Except for California, none of the mandatory cumulative voting states have statutes preventing its avoidance by the simple expedient of incorporating (or reincorporating) in a state with permissive cumulative voting.

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47. *Id.* at § 2115(e); CAL. CORP. CODE § 301.5(a) (West Supp. 1990).

48. Louart Corp. v. Arden Mayfair, No. C-192-091 (Super. Ct. Los Angeles County, May 1, 1978), *quoted in* 3 H. MARSH, MARSH'S CALIFORNIA CORPORATION LAW § 25.17 (Supp. 1988).

49. Wilson v. Louisiana-Pacific Resources, Inc., 138 Cal. App. 3d 216, 222-31, 187 Cal. Rptr. 852, 856-63 (1982). *See* Buxbaum, *The Threatened Constitutionalization of the Internal Affairs Doctrine in Corporation Law*, 75 CALIF. L. REV. 29, 40-43 (1987); Kozyris, *Corporate Wars and Choice of Law*, 1985 DUKE L.J. 1, 57-61 (1985); Oldham, *California Regulates Pseudo-Foreign Corporations—Trampling Upon the Tramp?*, 17 SANTA CLARA L. REV. 85 (1977).

D. Reducing the Impact of Cumulative Voting

1. Reducing the number of directors

If cumulative voting cannot be eliminated or avoided, its effective use may still be circumvented by reducing the number of corporation directors.[50]

Table 3 illustrates the diminished ability of minority shareholders to elect directors of a corporation (using cumulative voting) as the total number of directors is strategically reduced. Assume the majority shareholders have 1000 votes and the minority shareholders have 225 votes. With six directors to be elected, the minority shareholders can elect one director, but if the number of directors to be elected is reduced from six to four, the minority shareholders do not have sufficient voting power to elect any directors.

Table 3: Number of Directors Reduced

Number of Directors	Number of Directors Elected by Minority	% of Minority Representation
9	2	22%
8	2	25%
7	1	14%
6	1	16%
5	1	20%
4	0	0%
3	0	0%
2	0	0%
1	0	0%

Suppose, however, the minority shareholders have 550 votes instead of 225 votes, with the majority shareholders continuing to have 1000 votes, would the tactic of reducing the total number of directors still be effective to eliminate minority represen-

50. *See* REVISED MODEL BUSINESS CORP. ACT § 8.03 (the power to change the number of directors is vested in the board of directors or shareholders). The use of this tactic assumes that the cumulative voting system applies, but focuses on changes in the number of directors as a means of preventing the election of minority directors, or reducing their number. *E.g.*, State *ex rel.* Starkey v. Alaska Airlines, Inc., 68 Wash. 2d 318, 320, 413 P.2d 352, 354 (1966) ("Due to a bylaw change . . . the number of directors . . . was increased from 11 to 13, thereby reducing to 2 the number of directors who could be elected by the minority faction voting their shares cumulatively."); Diamond v. Parkersburg-Aetna Corp., 146 W. Va. 543, 122 S.E.2d 436 (1961) (number of directors reduced from eight to three to avoid minority representation).

tation? The minority shareholders could continue to elect at least one director, unless the total number of directors to be elected was reduced to the extreme of only one.[51] Twenty-six states allow a corporation to have only one director.[52]

Statutes such as the following from Missouri have been adopted in response to the tactic of reducing the number of directors to avoid minority representation:

> The number of directors shall not be decreased to less than three by amendment to the articles of incorporation when the number of shares voting against the proposal for decrease would be sufficient to elect a director if such shares were voted cumulatively at an election of three directors.[53]

This statute, however, offers minority shareholders only

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51. *See supra* note 24 and accompanying text. Calculation shows that 389 votes are necessary to elect one out of a total of three directors, and 518 votes are necessary to elect one out of a total of two directors. Thus, with 550 votes the minority shareholders could elect one out of a total of three directors and one out of a total of two directors. However, if only one director is elected, that director will be elected by the majority shareholders.

52. ALA. CODE § 10-2A-58 (1987); ARIZ. REV. STAT. ANN. § 10-036 (1977); DEL. CODE ANN. tit. 8, § 141 (1983 & Supp. 1988); FLA. STAT. ANN. § 607.114 (West 1977); IDAHO CODE § 30-1-36 (1980); ILL. ANN. STAT. ch. 32, paragraph 8.10 (Smith-Hurd 1985); IND. CODE ANN. § 23-1-33-3 (Burns Supp. 1989); IOWA CODE ANN. § 496A.34.35 (West Supp. 1989); KAN. STAT. ANN. § 17-6301 (1988); KY. REV. STAT. § 271B.8-030 (Michie/Bobbs-Merrill Supp. 1989); MICH. COMP. LAWS § 450.1505 (1973); MINN. STAT. ANN. § 302A.203 (West 1985); MISS. CODE ANN. § 79-4-8.03 (Supp. 1988); MO. ANN. STAT. § 351.315 (Vernon Supp. 1989); MONT. CODE ANN. § 35-1-402 (1987); NEB. REV. STAT. § 21-2036 (1987); NEV. REV. STAT. § 78.115, (1987); N.H. REV. STAT. ANN. § 293-A:36 (1987); N.M. STAT. ANN. § 53-11-36 (1983); N.D. CENT. CODE § 10-19.1-33 (1985); OKLA. STAT. ANN. tit. 18, § 1027 (West Supp. 1989); OR. REV. STAT. § 60.307 (1987); R.I. GEN. LAWS § 7-1.1-34 (1985); S.C. CODE ANN. S33-8-103 (Law. Co-op. Supp. 1988); S.D. CODIFIED LAWS ANN. § 47-5-4 (1983); TENN. CODE ANN. § 48-18-103 (1983); VA. CODE ANN.§ 13.1-675 (1985); WASH. REV. CODE ANN. § 23A.08.350 (West Supp. 1989); W. VA. CODE § 31-1-21 (1988); WIS. STAT. ANN. § 180.32 (West Supp. 1988).

Two states and the District of Columbia require a minimum of three directors: D.C. CODE ANN. § 29-333 (1981); 15 PA. CONS. STAT. ANN. § 1402 (Purdon Supp. 1988); TEX. REV. CIV. STAT. ANN. art. 1396-2.15 (Vernon 1980).

Sixteen states normally require a minimum of three directors, but allow two directors if there are only two shareholders and one director if there is only one shareholder: ALASKA STAT. § 10.05.177 (1985); ARK. STAT. ANN. § 4-26-802 (1987); CAL. CORP. CODE § 212 (West Supp. 1989); COLO. REV. STAT. § 7-5-102 (1986); CONN. GEN. STAT. ANN. § 33-314 (West 1987); GA. CODE ANN. § 14-2-141 (Supp. 1988); HAWAII REV. STAT. § 415-36 (Supp. 1988); LA. REV. STAT. ANN. § 12:81 (West 1969 & Supp. 1989); ME. REV. STAT. ANN. tit. 13-A, § 703 (1981); MD. CORPS. & ASS'NS CODE ANN. § 2-402 (Supp. 1988); MASS. GEN. LAWS ANN. ch. 156B, § 47 (West Supp. 1989); N.J. STAT. ANN. § 14A:6-2 (West 1969); N.Y. BUS. CORP. LAW § 702 (McKinney 1986); N.C. GEN. STAT. § 55-25 (1982); OHIO REV. CODE ANN. § 1701.56 (Anderson 1985); UTAH CODE ANN. § 16-10-34 (Supp. 1988); VT. STAT. ANN. tit. 11, § 1882 (1984); WYO. STAT. § 17-1-134 (1987).

53. MO. ANN. STAT. § 351.090(3)(a) (Vernon Supp. 1989).

limited protection. Consider the Missouri statute in relation to the example in Table 3 with the minority shareholders having 225 votes. Under these facts the majority shareholders may reduce the total number of directors to four and thereby eliminate all minority representation. This action is not prohibited, because the number of directors is not reduced to less than three.

On the other hand, if the Missouri statute is applied to Table 3, with the minority shareholders having 550 votes the majority shareholders may not reduce the total number of directors to one and thereby eliminate all minority representation. With 550 votes the minority shareholders can elect "a director" in an election of three directors (a minimum of 388 votes are needed to elect one out of three directors), and the statute does not allow the number of directors to be decreased to less than three.[54]

2. Using classes of directors and shareholders

a. Classification of directors. Classification of directors is closely related to reduction in the number of directors in terms of its effect on cumulative voting. Classification provides the majority shareholders with many of the same advantages as reducing the number of directors, without actually reducing them.

For example, in Table 3 (minority shareholders with 225 votes) the majority shareholders were able to eliminate minority representation on the board, but to accomplish that result they had to reduce the total number of directors from six to four. With the classification of directors, however, the minority directors can be eliminated while the number of directors remains at six. To accomplish this result, the six directors described in Table 3 may be divided into two classes of three directors. Each class of directors may be given a term of two years with each class coming up for election every other year ("staggered" terms). Table 3 shows that if only *three* directors (instead of six) are to be elected at one time, the minority shareholders cannot elect any directors. Thus, by using two classes of directors with staggered terms the total number of directors in Table 3 remains at six, but all of those directors are elected by the majority shareholders.

Courts and commentators have been divided about whether the classification of directors can be used to avoid the election of

54. *See supra* note 24 (formula to calculate the minimum number of votes necessary to elect a given number of directors).

minority directors by cumulative voting.[55] Such a tactic was used in *Humphrys v. Winous Co.*,[56] where majority shareholders subject to mandatory cumulative voting voted to rearrange the board of directors into three classes, with one director in each class. The effect was that a minority shareholder with forty per cent of the stock could obtain no representation on the board. The minority shareholder complained that the statutory right to classify directors could not be used to defeat the effective use of the statutory right to vote cumulatively. The Ohio Supreme Court disagreed and concluded that the statute providing for classification of directors had equal dignity with the statute providing for cumulative voting.[57] Each statute provided a right without a guaranteed result. Each right, like a chess piece, could be moved about by the corporate players to achieve maximum advantage. The court held that the "[cumulative voting statute] guarantees to minority shareholders only the right of cumulative voting and does not necessarily guarantee the effectiveness of the exercise of that right to elect minority representation on the board of directors."[58]

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55. *See generally* Janney v. Philadelphia Transp. Co., 387 Pa. 282, 128 A.2d 76 (1956) (division of directors into three classes with one class elected each year did not violate right to vote cumulatively); Wolfson v. Avery, 6 Ill. 2d 78, 126 N.E.2d 701 (1955) (division of directors into three classes with one class elected each year violated right to vote cumulatively); Comment, *Corporations—Cumulative Voting, Classified Boards and Proportional Representation*, 55 MICH. L. REV. 997 (1957); Comment, *supra* note 20; Note, *Corporations—Cumulative Voting—Stagger System—Unconstitutional*, 9 MIAMI L.Q. 365 (1955).

56. 165 Ohio St. 45, 133 N.E.2d 780 (1956). *See generally* Note, *Cumulative Voting and Classified Directorates*, 64 W. VA. L. REV. 325 (1962); Comment, *Cumulative Voting Versus Classification of Directors in Missouri*, 22 MO. L. REV. 38 (1957); Comment, *Corporations—Cumulative Voting—Classification of Directors of a Closely-Held Corporation Held Not to Violate Statute Requiring Cumulative Voting*, 42 MINN. L. REV. 139 (1957); Comment, *Corporations—Cumulative Voting—Staggered Elections and Classification of Directors*, 18 MONT. L. REV. 107 (1956).

In *Humphrys*, a decision of the Ohio Court of Appeals 125 N.E. 2d 204 was reversed by the Ohio Supreme Court (133 N.E.2d 780). For commentary on the Court of Appeals decision, see Adkins, *Corporate Democracy and Classified Directors*, 11 BUS. LAW., 31, 35 (1955); Comment, *Cumulative Voting and Classification of Directors*, 7 MERCER L. REV. 227 (1955); Note, *Cumulative Voting and Classification of Directors—The Wolfson and Winous Cases*, 30 ST. JOHN'S L. REV. 83 (1955); Note, *The Conflict of Cumulative Voting and Staggered Directorships*, 24 U. CIN. L. REV. 560 (1955).

57. *Humphrys*, 165 Ohio St. at 59, 133 N.E.2d at 789.

58. *Humphrys*, 165 Ohio St. at 59, 133 N.E.2d at 789. *Accord* McDonough v. Copeland Refrigeration Corp., 277 F. Supp. 6 (E.D. Mich. 1967); Stockholders Comm. for Better Management v. Erie Tech. Products, 248 F. Supp. 380 (W.D. Pa. 1965) (minority shareholders could elect one director, but with classification they could elect none); Bohannan v. Corporation Comm., 82 Ariz. 299, 313 P.2d 379 (1956) (staggered voting

Section 8.06 of the Revised Model Business Corporation Act protects minority shareholders by placing a boundary line on tactics such as that described in *Humphrys* by requiring a minimum of nine directors before classification is allowed, and then by allowing no more than three classes.[59] The effect of the limitation of section 8.06 is that no class will have less than three directors. With such a protective statute the minority shareholder in *Humphrys* could have elected one director in each class, but the minority shareholders in Table 3 (with 225 votes) would still be without representation.

Twenty-two states use language similar to section 8.06 of the Revised Model Business Corporation Act.[60] Fifteen states and the District of Columbia allow no more than three or four classes of directors, but allow any number of directors in each class.[61] Illinois requires a minimum of six directors in order to

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may be used even though it diminishes cumulative voting right, but classes cannot be reduced to one director because that eliminates cumulative voting); Janney v Philadelphia Transp. Co. 387 Pa. 282, 128 A.2d 76 (1957); Commonwealth *ex rel.* Laughlin v. Green, 351 Pa. 170, 40 A.2d 492 (1945) (division of 12 directors into three classes of four directors each prevented minority shareholders from electing any directors). *Contra* Kern v. Chicago & Eastern Ill. R.R., 31 Ill. App. 2d 300, 309, 175 N.E.2d 408, 412, (1961) (staggered voting cannot be used to defeat cumulative voting: "Otherwise the [cumulative voting] right is a snare and a delusion. To defeat the [cumulative voting] right, if their position were correct, the majority stockholders could always establish enough classes to outvote the holders of the minority stock"); State *ex rel.* Syphers v. McCune, 143 W.Va. 315, 101 S.E.2d 834 (1958); Wolfson v. Avery, 6 Ill. 2d 78, 126 N.E.2d 701 (1955).

59. Section 8.06 provides in part, "If there are nine or more directors, the articles of incorporation may provide for staggering their terms by dividing the total number of directors into two or three groups, with each group containing one-half or one-third of the total, as near as may be." REVISED MODEL BUSINESS CORP. ACT § 8.06 (1988).

60. Twenty-two states permit classification of directors into two or three staggered classes, with further requirements that provide, in effect, for a minimum of three directors in each class: ALA. CODE § 10-2A-59 (1987); ALASKA STAT. § 10.05.186 (1985); ARIZ. REV. STAT. ANN. § 10-037 (Supp. 1988); ARK. STAT. ANN. § 4-27-806 (Supp. 1987); GA. CODE ANN. § 14-2-143 (1982); HAWAII REV. STAT. § 415-37 (Supp. 1988); IDAHO CODE § 30-1-37 (Supp. 1989); KY. REV. STAT. §271B.8-060 (Michie/Bobbs-Merrill Supp. 1988); ME. REV. STAT. ANN. tit. 13-A, § 705 (1981); MISS. CODE ANN. § 79-4-8.06 (Supp. 1988); MONT. CODE ANN. § 35-1-403 (1987); NEB. REV. STAT. § 21-2037 (1987); N.H. REV. STAT. ANN. § 293-A:37 (1987); N.M. STAT. ANN. § 53-11-37 (1983); N.C. GEN. STAT. § 55-26 (1982); OHIO REV. CODE ANN. § 1701.57 (Anderson 1985); R.I. GEN. LAWS § 7-1.1-35 (1985); S.C. CODE ANN. § 33-8-105 (Law. Co-op. Supp. 1988); S.D. CODIFIED LAWS ANN. § 47-5-5 (1983); TEX. REV. CIV. STAT. ANN. vol. 34, art. 2.33 (Vernon 1980); VT. STAT. ANN. tit. 11, § 1883 (1984); WASH. REV. CODE ANN. § 23A.08.360 (1969).

61. Ten states and the District of Columbia allow classification into two or three classes of directors, but provide no minimum on the number directors in each class: DEL. CODE ANN. tit. 8, § 141, (1983 & Supp. 1988); D.C. CODE ANN. § 29-334 (1981); IND. CODE ANN. § 23-1-33-6 (Burns Supp. 1989); IOWA CODE ANN. § 496A.36 (West 1962); KAN. STAT. ANN. § 17-6301 (1988); MICH. COMP. LAWS § 450.1506 (1973); OKLA. STAT. ANN. tit. 18, § 1027 (West Supp. 1989); TENN. CODE ANN. § 48-18-106 (1988); UTAH CODE ANN. § 16-10-

have a classified board, and allows no more than three classes.[62] Eight states have no limitations related to classification.[63] In contrast in "Unlisted" domestic corporations, California has no provision expressly dealing with classification, but does have a statute requiring that all directors must be elected each year.[64]

One weakness of these protective statutes is that they view "classification" only in the dimension illustrated in *Humphrys*, where directors were classified. These protective provisions do not always take into account that stockholders may also be "classified" in ways which impair the effective use of cumulative voting.[65]

b. Stockholder classification. An example of stockholder classification is *Walden Investment Group v. Pier 67, Inc.*[66] The articles of incorporation of Pier 67 Inc. provided that "the 'Class B' shareholders of the Corporation shall be entitled to a twenty-five per cent position in the Corporation." The acknowledged purpose of this provision was to give the Class B shareholders "*enhanced* voting rights."[67] This provision was interpreted to uphold elections for two groups of directors, at one of which only the Class B shareholders could vote. The excluded shareholders claimed that the right to vote cumulatively was unlawfully impaired by this classification. The Washington Supreme Court disagreed and implied that statutes intended to prevent abuses in relation to the classification of *directors* were not necessarily

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35 (1987); VA. CODE ANN. § 13.1-678 (1985); WIS. STAT. ANN. § 180.33 (West Supp. 1988).

Four states allow four classes of directors, but provide no minimum on the number of directors in each class: FLA. STAT. ANN. § 607.114 (West 1977); NEV. REV. STAT. § 78.330 (1987) (at least one-fourth of directors must be elected annually); N.Y. BUS. CORP. LAW § 704 (McKinney 1986); PA. CONS. STAT. ANN. tit. 15, § 1403 (Purdon Supp. 1988) (repealed effective October, 1989) (term of office cannot exceed four years).

62. ILL. ANN. STAT. ch. 32 ¶8.10 (Smith-Hurd 1985).

63. CONN. GEN. STAT. ANN. § 33-314 (West 1987); LA. REV. STAT. ANN. § 12:81 (West 1969 & Supp. 1989); MD. CORPS. & ASS'NS CODE ANN. § 2-404 (1985); MASS. GEN. LAWS ANN. ch. 156B, § 50 (West 1970); MINN. STAT. ANN. § 302A.213 (West 1985); MO. ANN. STAT. § 351.315 (Vernon Supp. 1989); N.J. STAT. ANN. 14A:6-4 (West Supp. 1989); N.D. CENT. CODE § 10-19.1-38 (1985).

64. CAL. CORP. CODE § 301 (West Supp. 1989); CAL. CORP. CODE § 301.5 (West Supp. 1990).

65. *E.g.*, State *ex rel.* Frank v. Swanger, 190 Mo. 561, 89 S.W. 872 (1905) (articles of incorporation which excluded holders of preferred stock from voting did not violate mandatory cumulative voting provision of Missouri constitution); *contra* People *ex rel.* Watsche Tel. Co. v. Emmerson, 302 Ill. 300, 134 N.E. 707 (1922) (constitution provided that every stockholder could vote cumulatively for directors and preferred stock could not be deprived of right to vote).

66. 29 Wash. App. 28, 627 P.2d 129 (1981).

67. *Id.* at 29, 627 P.2d at 130 (emphasis added).

applicable to related problems in relation to the classification of *shareholders*. Specifically, the court said, with reference to *Humphrys*, that the cumulative voting rights of the plaintiffs were not violated because this was not a classification of directors "in the traditional sense."[68]

Although the classification of shareholders was used in *Pier 67* to enhance the voting rights of a class of shareholders, it may also be used to *diminish* the voting rights of a class of shareholders. If the classification of *shareholders* is used to diminish cumulative voting rights, the statutory provisions offering protection against classification of directors may not be helpful. For example, section 7.28 of the Revised Model Business Corporation Act, which describes cumulative voting, does not prevent the division of shareholders or directors into classes because section 7.28 allows shareholders to cumulate votes and vote only for those candidates "for whom they are entitled to vote,"[69] thus implicitly recognizing that all shareholders may not be allowed to vote for all candidates.

Likewise, section 8.06 of the Revised Model Act, which requires a minimum of three directors in each class, may not prevent the classification of shareholders to diminish the cumulative voting right because shareholder classification is not, following the perspective of the *Pier 67* court, a "traditional" means of classification.[70] Even if it is applicable, section 8.06 could conceivably be disregarded in relation to cumulative voting if it is viewed as being no more than co-equal[71] with the right to provide voting rights and preferences to distinct classes of shares.[72] Moreover, California's statute requiring that all directors be elected each year[73] offers no protection from shareholder classification because, in fact, the directors are all elected each year.

3. *Using unequal voting rights*

As illustrated in *Pier 67*, the classification of directors or shareholders can have the effect of creating unequal voting rights. Ordinarily, each shareholder is entitled to one vote for

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68. 29 Wash. App. at 31-32, 627 P.2d at 131.
69. REVISED MODEL BUSINESS CORP. ACT § 7.28(c) (1988).
70. *See supra* note 68 and accompanying text.
71. *See supra* note 58 and accompanying text.
72. REVISED MODEL BUSINESS CORP. ACT § 6.01, 7.21 (1988).
73. CAL. CORP. CODE § 301 (West Supp. 1989).

each share of stock unless the articles of incorporation otherwise provide.[74] It is possible, however, to divide the stock of a corporation into classes for the direct purpose of giving one class of stock greater voting rights per share (e.g., 10 votes per share) than are given to other classes of stock. The difference in the voting rights of each class of stock can vary widely. "Differentials vary, such as 10 votes per share for one class and one vote for the other, or one vote per share for one class and one-tenth vote for another or a nonvoting class coexisting with a voting class."[75]

Dual classes of stock with unequal voting rights are often created as a defense against hostile takeovers.[76] A common scenario has two classes of stock: Class A with one vote per share and Class B with ten votes per share.[77] In 1988, Media General Inc., for example, had such an arrangement and was able to defeat an attempted takeover because insiders who held fourteen per cent of the outstanding stock nevertheless controlled seventy per cent of the vote because they controlled the Class B stock of the corporation which had ten votes per share.[78]

The potency of unequal voting rights in relation to cumulative voting can be illustrated by a return to Table 2 at the beginning of this article. Table 2 shows an election for directors using cumulative voting in which the majority shareholders have 1,000 shares and 1,000 votes, and the minority shareholders have 550 shares and 550 votes. Under those facts, using cumulative voting, the majority shareholders could elect four directors and the minority shareholders could elect two directors.

But if the facts in relation to Table 2 are changed so that the minority shareholders have 550 shares of "Class B" stock, with 10 votes per share, and the majority shareholders have 1000 shares of "Class A" stock, with one vote per share, the minority shareholders, using cumulative voting, can elect five of the six

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74. REVISED MODEL BUSINESS CORP. Act § 7.21(a) (1988).

75. *Failsafe Protection*, MERGERS & ACQUISITIONS, Nov.-Dec., 1986, at 17.

76. Sandler, *Dual Stock Categories Spur Powerful Debate Over Stability vs. Gain*, Wall St. J., May 17, 1988, at 1, col. 6.

77. *Id.*

78. *Id.* For cases dealing with unequal voting rights in relation to cumulative voting, see Walden Inv. Group v. Pier 67, Inc., 29 Wash. App. 28, 627 P.2d 129 (1981) (use of two classes of stock with unequal voting rights did not violate cumulative voting rights); Diamond v. Parkersburg-Aetna Corp., 146 W.Va. 543, 122 S.E.2d 436 (1961) (different voting rights for preferred stock and common stock did not violate cumulative voting rights).

directors, instead of the two they can expect with equal voting, and the majority shareholders can elect only one director, instead of the four they can expect with equal voting.[79]

How are the results changed if the Class B stock is held by the majority shareholders instead of the minority shareholders? The majority shareholders have 10,000 votes (1,000 shares x ten votes per share = 10,000 votes). In addition, with cumulative voting, the votes of the majority are multiplied by the six directors for whom they are entitled to vote with the result that the majority shareholders have 60,000 cumulative votes at their disposal. In contrast, the minority shareholders have 3,300 cumulative votes (550 shares/votes multiplied by six directors = 3,300 votes). In this context, even with cumulative voting, the majority shareholders can elect all six directors, and the minority shareholders can elect no directors.[80]

The simplest way to counter unequal voting rights is to require equal voting rights by state statute or constitutional amendment.

The Securities and Exchange Commission (SEC) has addressed the issue of unequal voting rights by adoption of a new Rule 19c-4. Effective July 7, 1988, Rule 19c-4 prohibits national securities exchanges from listing common stock or other equity securities of a company if the company creates classes of stock having unequal voting rights.[81] The rule also applies to national securities associations and prevents them from placing such

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79. The mathematics which allow the minority shareholders to elect five out of six directors using "Class B" stock (10 votes per share) and cumulative voting is as follows: the 550 minority "Class B" shares are multiplied by 10 votes per share which produces 5,500 votes; then, the 5,500 votes the minority are entitled to cast are multiplied by the six directors for whom they are entitled to vote, with the result that the minority can cast 33,000 votes. In contrast, the majority shareholders have only 6,000 votes (1,000 shares/votes x six directors = 6,000 votes). With 33,000 votes, out of a total of 39,000 votes, the minority shareholders can elect five out of six directors.

Application of the formula for predicting the minimum number of shares (votes) necessary to elect a given number of directors (*see supra* note 24) shows that with a total of 6,500 votes (before cumulating) (550 minority shares x 10 votes per share = 5,000 votes + 1000 majority shares/votes = 6,500 votes), 5,573 votes are necessary to elect six directors, and 4,644 votes are necessary to elect five directors. With 5,500 votes (before cumulating), the minority shareholders (voting "Class B" stock) can elect five directors.

80. Application of the formula for predicting the minimum number of shares (votes) necessary to elect a given number of directors (*see supra* note 24) shows that 9044 votes (before cumulating) are necessary to elect all six directors. With 10000 votes (before cumulating), the majority shareholders (voting "Class B" stock) can elect all six directors.

81. 17 C.F.R. § 240.19c-4 (1988), *reprinted in* 20 Sec. Reg. & L. Rep. (BNA) No. 28, at 1147 (July 15, 1988).

stock in their quotation or transaction reporting systems.[82] The disadvantage of this action is that it applies only to stock issued pursuant to section 12 of the Securities Exchange Act.[83]

4. Removal of directors

Finally, majority shareholders can eliminate minority directors (elected by cumulative voting) by using their power to remove directors from office without cause. After the election of minority directors, the majority shareholders can, by majority vote, remove the minority directors from office.[84] Then, the remaining directors can select replacement directors to fill the vacant positions,[85] and the ability of the minority shareholders to elect directors by cumulative voting, and retain them, is completely nullified.

Attempts by majority shareholders to abuse their power to remove directors can be remedied, however, by giving the minority shareholders the statutory right to prevent removal of "their" directors if they do not concur in the removal. Section 8.08(c) of the Revised Model Business Corporation Act, is an example of such a protective provision: "If cumulative voting is authorized, a director may not be removed if the number of votes sufficient to elect him under cumulative voting is voted against his removal."[86] If section 8.08(c) is applied to Table 2,

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82. *Id.*

83. *Id.*

84. *See, e.g.*, § 8.08(a) of the Revised Model Business Corporation Act: "The shareholders may remove one or more directors with or without cause unless the articles of incorporation provide that directors may be removed only for cause." REVISED MODEL BUSINESS CORP. ACT § 8.08(a) (1988).

85. *See, e.g.*, REVISED MODEL BUSINESS CORP. ACT § 8.05 (1988).

86. REVISED MODEL BUSINESS CORP. ACT, § 8.08(c) (1988). Forty-three states use provisions which offer protection against removal without cause to directors elected by cumulative voting: ALA. CODE § 10-2A-61 (1987); ARIZ. REV. STAT. ANN. § 10-039 (1977); ARK. STAT. ANN. § 4-26-804 (1987); CAL. CORP. CODE § 303 (West 1977); COLO. REV. STAT. § 7-5-105 (1986); DEL. CODE ANN. tit. 8, § 141, (1983 & Supp. 1988); FLA. STAT. ANN. § 607.117 (West 1977); GA. CODE ANN. § 14-2-145 (1982); HAWAII REV. STAT. § 415-39 (Supp. 1988); IDAHO CODE § 30-1-39 (1980); ILL. ANN. STAT. ch. 32 § 8.35 (Smith-Hurd Supp. 1989); IND. CODE ANN. § 23-1-33-8 (Burns Supp. 1989); LA. REV. STAT. ANN. § 12:81 (West 1969 & Supp. 1988); ME. REV. STAT. ANN. tit. 13-A, § 707 (1981); MD. CORPS. & ASS'NS CODE ANN. § 2-406 (1985); MICH. COMP. LAWS § 450.1511 (1973); MINN. STAT. ANN. § 302A.223 (West 1985); MISS. CODE ANN. § 79-4-8.08 (Supp. 1988); MO. ANN. STAT. § 351.315 (Vernon Supp. 1989); MONT. CODE ANN. § 35-1-408 (1987); NEB. REV. STAT. § 21-2039 (1987); NEV. REV. STAT. § 78.335 (1987); N.H. REV. STAT. ANN. § 293-A:39 (1987); N.J. STAT. ANN. 14A:6-6 (West Supp. 1989); N.M. STAT. ANN. § 53-11-39 (1983); N.Y. BUS. CORP. LAW § 706 (McKinney 1986); N.C. GEN. STAT. § 55-27 (1982); N.D. CENT. CODE § 10-19.1-41 (1985); OHIO REV. CODE ANN. § 1701.58 (Anderson Supp. 1988); OKLA. STAT.

the two directors elected by the minority shareholders cannot be removed if the minority shareholders produce that number of cumulative votes against the removal proposition which would be sufficient to elect the embattled directors, assuming the purpose of the vote was to elect directors and not to remove directors.[87]

There are isolated circumstances in which the protective language of section 8.08(c) will not protect a minority director. It may be possible in some cases for minority shareholders to "gamble" in the allocation of their cumulative votes and, because of unwise voting by their majority opponents, elect more directors than the number to which the minority are mathematically entitled.[88] The protective provisions of section 8.08(c) will not protect these "extra" minority directors. This is because after such an election, the majority shareholders may awaken to their error and, notwithstanding section 8.08(c), propose the removal of all of the minority directors. In the removal vote, with the majority now voting wisely, the only minority directors protected from removal by section 8.08(c) will be those whom the minority could now elect if their voting was to elect and not merely an opposition to removal. Under these facts the "extra" directors of the minority shareholders will be removed.

Not all jurisdictions with cumulative voting have a protective statute such as section 8.08(c).[89] In circumstances where cu-

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ANN. tit. 18, § 1027 (West Supp. 1989); ORE. REV. STAT. § 60.324 (1987); R.I. GEN. LAWS § 7-1.1-36.1 (1985); S.C. CODE ANN. § 33-8-108 (Law. Co-op. Supp. 1989); TENN. CODE ANN. § 48-18-108 (1988); TEX. REV. CIV. STAT. ANN. vol. 3A, art. 2.32 (1980); UTAH CODE ANN. § 16-10-37 (1987); VA. CODE ANN. § 13.1-680 (1985); WASH. REV. CODE ANN. § 23A.08.380 (Supp. 1989); W. VA. CODE § 31-1-96 (1988); WYO. STAT. § 17-1-135.1 (1987).

87. With respect to Table 2, the minority shareholders *needed* only 2658 cumulative votes to elect two directors (1329 votes each), although they had more votes than that. *See supra* note 24. The language of § 8.08(c) (quoted in the text) does not ask how many votes were cast to originally elect an embattled director (1650 votes with respect to Table 2). Instead, the focus is on the removal vote, and the question asked is whether the votes cast against removal would be sufficient to elect the embattled director "if *then* cumulatively voted at an election of the entire board of directors." In answer, if the Table 2 minority shareholders can cumulatively vote 1329 votes against the removal of each of "their" directors, those directors cannot be removed even though a greater number of votes was originally cast for their election.

88. Glazer, Glazer & Grofman, *supra* note 24, at 295 (analysis of hypothetical cumulative voting examples in which minority shareholders may elect more directors than the number to which they are mathematically entitled).

89. Alaska, Connecticut, Washington D.C., South Dakota and Vermont have cumulative voting provisions but do not have protective provisions such as section 8.08(c) of the Revised Model Business Corporation Act. Massachusetts and Wisconsin have no cumulative voting provisions and, consistent therewith, have no protective provisions.

mulative voting is allowed, but where there is no protective provision, minority shareholders who have lost directors to the removal power must persuade the courts that the power of majority shareholders to remove minority directors is an unreasonable infringement on the right of cumulative voting. Thus, in New York (1952), a bylaw was held invalid which allowed shareholders to remove, without cause, a director who had been elected by cumulative voting.[90] But, in Delaware (1957), it was held that the cumulative voting right would not prevent removal of a director, if the director was removed for cause.[91]

IV. SUMMARY

In a state with permissive cumulative voting, majority shareholders decide whether their corporation will use cumulative voting. If the decision has significance, the majority shareholders may be expected to vote against the use of cumulative voting.

Mandatory cumulative voting (available in a dwindling number of states) appears to take the power of choice away from the majority shareholders and imposes cumulative voting on the corporation. The reality, however, is that even in a mandatory cumulative voting state, the majority shareholders retain very real powers of avoidance. The simplest tactic is for majority shareholders to cause their corporation to incorporate (or reincorporate) in a permissive cumulative voting state, and thereafter return and do business (without cumulative voting) as

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90. *In re* Rogers Imports, Inc., 202 Misc. 761, 762, 116 N.Y.S.2d 106, 107 (1952) ("When this provision [cumulative voting] was inserted in the charter, it in effect invalidated the by-law insofar as it provided for removal of a director *without cause* . . . . If this were not so, of what use would be the cumulative voting provision when, immediately after an election the majority stockholder could then remove the director without cause? To hold that the by-law is still in full force and effect would render the subsequent cumulative voting provision meaningless."); Note, *Corporations—Rights and Powers of Minority Stockholders—Charter Amendment Providing for Cumulative Voting Impliedly Repeals By-Law Allowing Majority to Remove Director Without Cause*, 66 HARV. L. REV. 531 (1953).

91. Campbell v. Loew's Inc. 36 Del. Ch. 563, 573, 134 A.2d 852, 858 (1957) ("The possibility of stockholder removal action designed to circumvent the effect of cumulative voting is evident. This is particularly true where the removal vote is, as here, by mere majority vote. On the other hand, if we assume a case where a director's presence or action is clearly damaging the corporation and its stockholders in a substantial way, it is difficult to see why that director should be free to continue such damage merely because he was elected under a cumulative voting provision.").

a foreign corporation. California is the only state which even attempts to prevent use of this tactic.

If majority shareholders choose, for whatever reason, not to locate the corporation in a permissive cumulative voting state, they may still eliminate or minimize the effectiveness of cumulative voting by reducing the total number of directors of the corporation, using classes of directors or shareholders, using unequal voting rights for shareholders, or removing minority directors without cause.

The overwhelming control of majority shareholders in relation to cumulative voting suggests remedial action at the state or national level, if cumulative voting is to be effectively implemented.

IV. RECOMMENDATIONS

A. *State-Level Remedial Action*

As noted above, the corporation law in most states allows determined majority shareholders to evade cumulative voting. Of course, if the legislative bodies of those states were convinced that cumulative voting should be used, they could easily adopt mandatory cumulative voting,[92] together with provisions relating to foreign corporations,[93] changes in the number of directors,[94] classification of directors and shareholders,[95] unequal voting rights,[96] and removal of directors without cause,[97] which would prevent abuses in relation to the effective use of cumulative voting.

Realistically, however, there is little hope that the various states will adopt rules compelling the effective use of cumulative voting. This is due to competition among the states to attract new incorporations, and the revenues those new corporations bring with them.[98] A state which adopts restrictive corporate

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92. *See supra* note 30 and accompanying text.

93. *See supra* notes 43-49 and accompanying text.

94. *See supra* notes 50-54 and accompanying text.

95. *See supra* notes 55-73 and accompanying text.

96. *See supra* notes 74-83 and accompanying text.

97. *See supra* note 84 and accompanying text.

98. Note, *Cumulative Voting, Yesterday and Today: The July, 1986 Amendments to Ohio's General Corporation Law*, 55 U. CIN. L. REV. 1265, 1273-77 (1987) (Ohio abandoned mandatory cumulative voting to attract increased incorporations); Oldham, *supra* note 49, at 104, 106 n.79 ("the presence of states with enabling type corporation laws tends to force states with more restrictive corporations codes to abandon their statutory schemes and follow suit").

legislation, such as mandatory cumulative voting, faces the danger that revenue-rich corporations will move to a less restrictive state:

> Since corporations have been able to circumvent a state's corporations code merely by incorporating in another state, there has been no incentive for a state to enact a relatively strict code. Similarly, attempts by states to regulate corporate activities more stringently have been undermined by those states which have enacted "enabling" type codes [e.g. permissive cumulative voting]. Under the specter of their domestic businesses incorporating or reincorporating elsewhere, with the concomitant loss of charter fees, franchise taxes, and control over corporations which transact business in the state, restrictive states have amended their laws to make them more enabling.[99]

An example of a state abandoning mandatory cumulative voting in favor of permissive cumulative voting in an effort to attract new incorporation is the State of Ohio, which did so in 1986. One commentator was candid in admitting that competition to attract incorporations was a principal factor in the Ohio decision to abandon cumulative voting:

> If Ohio is to maintain its position, which is important to the citizens of this state in terms of employment opportunities and tax revenue, the legislature must be responsive to the needs of corporate decision-makers. This could mean a compromise of the historical desire to protect the rights of minority shareholders. While various commentators object to the perceived compromises states are forced to make in order to remain competitive, their objections have thus far proved largely ineffective in combatting the competitive measures taken by states.[100]

B. National Remedial Action

The wisdom of requiring the use of cumulative voting for corporation directors may be fairly debated.[101] If, however, the debate is resolved in favor of the required use of cumulative voting, the rule implementing it is best applied on a national basis. Action by individual states to require the use of cumulative voting will not be successful because "any attempt to provide such

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99. Oldham, *supra* note 49, at 104-5.
100. Note, *supra* note 98, at 1273-74.
101. Steadman & Gibson, *supra* note 6, at 9.

regulations [such as restrictive corporations codes] in the public interest through state incorporation acts and similar legislation would only drive corporations out of the state to more hospitable jurisdictions."[102]

The best analogy is the recent national concern about unequal voting rights.[103] Competition between the national securities exchanges and national securities associations prevented any one of them from taking an effective stand against abuses in relation to unequal voting rights. The solution was adoption by the Securities and Exchange Commission of Rule 19c-4 which applied a uniform rule and eliminated the temptation for corporations to "shop around" for a more favorable deal.

In like manner, if cumulative voting is to be effectively implemented, it is best done on a national basis,[104] by legislation or regulation which requires all corporations of a similar class to use cumulative voting. The National Banking Act provides evidence that national legislation is a practical solution. Since 1933, that Act has required cumulative voting on the part of all national banks.[105]

V. Conclusion

In principle, cumulative voting is attractive because it allows majority and minority shareholders representation on the board of directors in rough proportion to the number of their votes. But, the principle of proportional representation is illusory because majority shareholders, like a fox guarding a hen house, are in almost complete control. If the states were agreed on the principle of cumulative voting it is arguably within their power to unitedly adopt uniform legislation to implement it. That, however, is not likely because the trend away from mandatory cumulative voting shows that most states cannot resist the competitive urge to abandon cumulative voting in an effort to attract corporations. The practical solution is a national rule, like the National Banking Act, which would impose cumulative voting on all corporations of a similar class.

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102. *Report of the Corporation Law Revision Commission* in N.J. Stat. Ann. § 14A, at XI (West 1969), *quoted in* Oldham, *supra* note 49, at 107 n.81.

103. *See supra* note 81 and accompanying text.

104. *See supra* note 98 and accompanying text.

105. 12 U.S.C. § 61 (1982).