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VOTING TRUSTS AND NON-VOTING STOCK

MILTON M. BERGERMAN

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The practice of depriving stockholders of the right to participate in the management of large corporations by means of such devices as the voting trust and non-voting stock has become so widespread that the legal status of these methods of disenfranchising shareholders assumes a new importance.1

The object of this paper is to approach this legal question by way of pointing out how both voting trusts and non-voting stock involve the interesting problem of the social policy of allowing or disallowing a minority in financial interest to control corporate enterprise.2

In the following discussion, Part I is an attempt to analyze the decisions on voting trust agreements. Part II is a treatment of non-voting stock and the social policy of minority control in general. Before considering the subject matter of either Part I or Part II, however, it has been deemed essential to develop the historical background of the corporation in order to illuminate the attitude of the modern law toward problems of corporate control.

The first corporations were primarily political units to which the crown directly granted sovereign power to exercise political functions.3 In the latter part of the fourteenth century the craft guilds began to be organized and incorporated.4 A group

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1 The legal status of the voting trust has been frequently discussed. Cushing, Voting Trusts (2d ed. 1927); Baldwin, Voting Trusts (1891) 1 Yale Law Journal 1; Wormser, The Legality of Corporate Voting Trusts and Pooling Agreements (1918) 18 Col. L. Rev. 123; Smith, Limitations on The Validity of Voting Trusts (1922) 22 Col. L. Rev. 627; Finkelstein, Voting Trust Agreements (1926) 24 Mich. L. Rev. 344. There is very little material on the legal aspects of non-voting stock. See Berle, Non-voting Stock and "Bankers' Control" (1926) 39 Harv. L. Rev. 673.

2 This problem is also raised by the practice of pyramiding—the formation of a string of holding companies—prevalent in the public utility field. Consideration of this aspect of the problem is omitted because adequate treatment would require very extended comment on matters beyond the scope of this paper. For an interesting discussion see Professor Ripley's new book, Main Street and Wall Street (1927) c. 5.


4 The merchant guilds existed prior to the craft guilds but they were mere associations without a charter. As to reasons why the craft guilds incorporated and persisted, see 1 Davis, op cit. supra note 3, at 195-6; ibid. 93-4.
of men applied to the crown for a grant of power to regulate a
given trade. At about the same time the inhabitants of certain
towns, having some time before separated themselves from the
feudal system and formed autonomous groups, applied to the
crown for permission to set up local governments in more com-
plete and substantial form, as corporations. This was a terri-
torial political organization, the former was a functional political
organization. These were the first corporations.\(^5\)

Both types of corporation exercised governmental functions.
They passed local statutes, binding on members and non-
members alike, and they had the power to enforce their laws
under the supervision of the king's courts.\(^6\)

The modern business corporation developed from the guild
organization. Great commercial corporations were organized to
carry on trade abroad. They were given the power to regulate
that trade in foreign lands in much the same way as the guilds
had been given power to regulate trade at home.\(^7\) It was then
only a short step to the formation of the modern business corpo-
rations, without monopoly powers, and for the sole purpose, in
theory as in fact, of earning wealth for its members.\(^8\)

In the body of law that had been developing on this subject,
these business organizations were immediately classed with the
older corporations, although their essential difference in every-
thing but name and form is apparent. So we find no distinction
in the early law between any of the four very different kinds of

\(^5\) Perhaps ecclesiastical and eleemosynary corporations must also be in-
cluded as early types. See 9 Holdsworth, A History of English Law
(1926) 58; 1 Davis, op. cit. supra note 3, c. 3.

\(^6\) 1 Davis, op. cit. supra note 3, at 154.

\(^7\) This began by the chartering of the so-called "regulated companies"
in the beginning of the 16th century (there were some even earlier) which
finally developed into the joint stock company. Even joint stock companies
retained some of their governmental powers until very recent times. For
an example of the grants of governmental powers to regulated companies
see the charter of the Merchants of Andalusia (1530) Patent Rolls, 22 Hen.
VIII, pt. 2; Carr, Select Charters of Trading Companies (Selden, 1913)
1. For examples in the case of joint stock companies, see the charter of
the Russian Company (1555), the first important joint stock company, in 1
Scott, The Constitution and Finance of English, Scottish and Irish
Joint Stock Companies (1912) 18. See also 8 Holdsworth, op. cit. supra
note 5, at 199-212; 2 Davis, op. cit. supra note 3, at 110. As late as 1600,
the charter of the East India Company authorized the members to "make
such ... reasonable laws ... as shall seem necessary and convenient for the
good government of (the company) ... if only they be reasonable and not con-
trary to the laws, statutes and customs of England and in order to enforce
them they might impose such punishment and penalties by imprisonment of
body or by fines and amercements upon all offenders ... ."

\(^8\) Carr, op. cit. supra note 7, at xxii; 8 Holdsworth, op. cit. supra note 5,
at 205.
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corporations—guild, town, church and business. Legal principles which developed when political corporations were the prevailing types were applied indiscriminately to the business corporation.

The paramount consideration in the early political corporation was to secure the general welfare of a relatively large group. Even when the trading companies like the East India Company were formed, they were given far reaching powers because they were considered part of the government, established in the general interest of English trade. It is natural that the exercise of powers so directly connected with public welfare should come under the close supervision of the courts. As may well be expected, they took a live interest in the internal management of such corporations.

On the other hand, the purpose and function of the business corporation was not at all specially or directly connected with the public welfare. There is no reason for the close supervision of the internal management of such enterprises, but the courts, misled by conceptual similarity, insisted on regulating such corporate affairs.

At first they did even more than this. Having formulated definite standards for the internal government of public corporations on the basis of a widespread political theory, they applied these same standards to private corporations with the result that plural voting and proxy voting were not allowed. "One man, one vote" was a result of a political philosophy which assumed that every man had an equal interest in good government and that the highest governmental wisdom, in the form of the decision of the majority, would result from the clash of these

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9 Williston, op. cit. supra note 3, at 123; 1 BL. COMM. c. 18. Blackstone distinguishes between corporations sole and aggregate. Ibid. 476-7. He also makes some distinctions between lay and ecclesiastical corporations, especially regarding the Statute of Mortmain. 2 ibid. 208-9.

10 "It was from the point of view of trade organization and foreign policy of the state rather than from the point of the interests of the persons composing the company—from the point of view of public rather than commercial law—that the corporate form was valued." 2 HOLDSWORTH, op. cit. supra note 5, at 202.

11 "Modern corporations seem to be substantially new bodies, modern not only in time but also in the nature of their activity." 2 DAVIS, op. cit. supra note 3, at 248.

12 There may well be a new social interest in the internal management of modern corporations as a result of their recent growth, resulting in unusual economic power being wielded by those in control, on the one hand, and in the resulting number of the public concerned both in consuming their products and holding their securities on the other. But this factor raises new problems and certainly did not enter into the development outlined above.

13 Taylor v. Griswold, 14 N. J. L. 222 (1834) and English cases therein cited.
interests. To allow a man more than one vote would throw the whole mechanism for arriving at truth out of gear. Any device which resulted in taking men's hearts and minds away from the conflict was to be condemned. The Court said in *Taylor v. Griswold.*

"The object of the legislature was to give permanency and protection to the public improvement that had been erected and security to the individuals who had embarked on the enterprise. Instead of promoting and securing these legislative designs, the tendency ... of the by-laws in question [allowing plural voting] is to encourage speculation and monopoly, to lessen the rights of small stockholders, depreciate the value of their shares and to throw the whole property and government into the hand of a few capitalists." (Italics the writer's).

When corporations began to be used primarily in the production of wealth, and to be formed in large numbers for that purpose, the law began to draw the distinctions it failed to draw when this type was less numerous. The fact of private interest in business corporations was thoroughly recognized and, gradually, voting was made proportional to the amount of stock held, this tendency resulting finally in the adoption of statutes allowing one vote for each share of stock held. Statutes were passed allowing proxy voting, a further recognition of the non-political character of modern corporations.

But the effect of the prior confusion persisted in several aspects. The courts still insisted on regulating the internal management of the corporation. The philosophy of government which guided this regulation—the belief in majority rule—remained the same. But there was this change in the application of their philosophy: there was substituted for the general interest which one has in the successful functioning of government the interest which one has as an investor in the success of a money-making project. In the former a *majority in general interest* is supposed to emerge from the voting contest with a wise governmental policy; in the latter a *majority in financial interest* determines correct corporate policy as a result of a similar conflict of honest judgments and opinions. Hence the

14 *Supra* note 13.
15 "... as to the points which belong exclusively to the conception of the business corporation, the law has been formed very largely since 1800." Williston, *op. cit. supra* note 3, at 113.
16 In some instances proxy voting was allowed in later corporations at common law. See *People v. Crossley,* 69 Ill. 195 (1873).
17 "The fact that it is a business corporation in no wise dispenses with the obligation of all members to assemble together, unless otherwise provided, for the ... election of their officers." See *Commonwealth v. Bringhurst,* 103 Pa. 134, 138 (1883). Here the court declared that a proxy vote was invalid.
mechanism of "majority rule" was taken over from politics modified only in so far as a majority in financial interest was substituted for a numerical majority.\footnote{13}

Having accepted the theory that those who own a majority of the assets will best govern the corporation, the courts can be expected to react against devices which deprive investors in corporate stock of voting power. Such devices put the management of the corporation into the hands of people having little or no financial interest in the enterprise. This so called "inside management" thus exercises a power substantially disproportionate to its investment in the corporation. Control is taken from owners of a majority of the capital stock and is exercised by a financial minority. Thus voting trusts and non-voting stock, involving minority rule in corporate enterprise, must overcome the prejudices of courts steeped in the general doctrine of rule by the majority.

The point of this analysis thus far is that the law tends to look inimicably upon minority rule or the separation of control from beneficial ownership because of a political analogy. This is the result of similarity in form between business corporations and political units. But this is at most only a tendency, and there has been concurrently a desire to condemn this separation on the merits of the case against it.

It is generally believed that a man will make the best possible use of his own property, even from a social viewpoint. Remove the risk of loss as a deterrent and a reckless and foolish policy results. Thus Professor Ripley\footnote{18} concludes that the separation of power from financial interest is a social evil:

"Fundamental these changes [post-war business changes] are, inasmuch as they strike at the very tap-root of our capitalistic system. For this system is founded on the theory that private, as distinct from the common ownership of property, best conduces to the public welfare because such possession involves the giving of a gage or guaranty by the owner to his fellow citizens for thrifty, efficient, far-sighted and public spirited management thereof. His is the reward if he be successful. And he bears the loss in case of misdirection. Otherwise stated, it is the fundamental principle, interwoven throughout all human relationships, that power and responsibility must ever be yoked together. . . . [These tendencies] put the public interest in sound and straight-

\footnote{18 It must be pointed out that the writer has made no attempt to pass on the question of the origin of the concept of majority rule itself. A consideration of this matter is far beyond the scope of this paper. Even if the theory is adopted that "majority rule" originated right in the old political corporation, it in no way affects the problem at hand, which is that of tracing the application of the doctrine, wherever it came from, to the management of the business corporation.}

\footnote{185 Ripley, More Power to the Bankers (Dec. 2, 1925) 121 The Nation 618.}
forward business in jeopardy—not because bankers as such are more frail than other people in general but simply because the possession of uncontrolled power is almost certain to entail abuse whereby both innocent and guilty are alike dragged down."

It seems that both the political theorist in his analogy, and the economic theorist in his direct approach, have been misled by the historical background of the subject in their fundamental assumption that investors in modern corporations should control the management of the enterprise at all. While it may have been accurate to depict the stockholder as part owner and one of the managers far back in corporation history and in some corporations, to consider him such now is to make an entirely false picture. The average stockholder in the modern corporation is an investor who is willing to take the earning power of the company as his only security and is willing to forego steady income for possibilities of greater gain.

The reluctance of stockholders in general to exercise their voting privilege is a familiar aspect of modern corporate management. The fact is that they are not, and do not consider themselves part of the management. Non-voting stock and voting trust certificates are sold without difficulty to the investing public.

As a result of lack of interest of stockholders in management and the wide sale of securities in small lots, the "compact minority" rules corporate enterprise, as a practical matter. But the courts, in considering the problem of minority control raised by voting trusts and non-voting stock, are not considering this kind of minority control. They are not directly concerned with this larger problem of who shall really manage corporate enterprise in the last analysis. They are faced rather with the prospect of permanent, crystallized minority control.

Control resulting from the inertia of stockholders is in no way fixed. It may shift around and go into the hands of different minorities at different times, and it leaves open the continuing possibility of majority control. Minority control accomplished by voting trusts and non-voting stock is relatively permanent and crystallized. There is no possibility of change for a long period of time. The influence of the stockholder's vote as a check on management is eliminated.

Because of these peculiar considerations, the problem raised by voting trusts and non-voting stock, although intimately connected with the larger inquiry, is a distinct problem as a matter of analysis. Its special treatment here is further justified by

19 See 1 DEWING, FINANCIAL POLICY OF CORPORATIONS (1921) xiii. In a great many cases less than twenty per cent of the stock is sufficient to control the corporation. See RIPLEY, op. cit. supra note 2, at 95.
the fact that it is considered a separate problem in the decisions on voting trusts that will now be discussed.

I

Voting trusts are of four main classes:

A. Those that do not involve minority control.
B. Those which involve minority control incidentally in accomplishing a socially desirable end.
C. Those which are used to effectuate an illegal purpose.
D. Those which squarely present the problem of minority control.

It is submitted that the decisions can best be understood if the distinction between voting trusts involving minority control and all others is kept in mind.

A. VOTING TRUSTS NOT INVOLVING THE PROBLEM OF MINORITY CONTROL

In this group of cases the voting trust is generally legal. They must be carefully distinguished from cases which involve the problem of minority control.

1. Corporate Reorganization. The X Manufacturing Company is organized to manufacture a commodity requiring an extensive plant equipped with elaborate and expensive machinery. Twenty thousand shares of common stock are issued and a million dollar bond issue is floated, secured by a first mortgage on the plant and machinery. The company does business for a while and is unsuccessful. It fails to pay the interest on the outstanding bonds and the bondholders, through their trustee or a special committee, threaten to put the corporation into bankruptcy and wind up its affairs. This course of conduct would be unsatisfactory for both the stockholders of the corporation and the bondholders. On execution sale the machinery and plant would probably bring little more than a junk price and this may not even cover the amount of indebtedness. The stockholders would lose all their equity. Furthermore, there is a distinct advantage in continuing the business, if possible, even at a bare profit to avoid the delays and uncertainties of liquidation.

After a careful study of conditions the creditors decide that the business is fundamentally sound, that more capital is needed for further improvements and that conservative and intelligent management would run the now failing enterprise through to success. They are willing to lend the additional capital to the corporation but now they want to make sure of the whole investment. They demand control.\(^2^0\)

\(^2^0\) Finkelstein, op. cit. supra note 1, at 351: "The writer had occasion to employ trust agreements in cases of this kind. Usually the difficulties in
The stockholders agree and the immediate bankruptcy of the corporation is averted. A majority of the stock is signed over to trustees, usually the bankers who had marketed the bonds and who now want to protect their clients' interests and their own reputations. The trustees agree to hold the stock for a long period, usually about fifteen years or until a certain amount of the indebtedness of the corporation is cleared off. They issue trust certificates for the shares of stock signed over to them. These trust certificates entitle the holders thereof to be paid the dividends derived from the stock. They are freely transferrable and have practically all the characteristics of stock except the voting rights, which the trustees now exercise.21

In return the creditors now lend the corporation more money, usually through an issuance of debenture bonds. If the reorganization is successful, the corporation regains its financial health, pays off its debentures and the trustees reassign the stock to the holders of the trust certificates.

This is a very simple case of a voluntary reorganization, used merely as an illustration. Reorganization cases vary greatly, depending upon complexity of financial structure, relative strength of various interests, and other factors which result in widely differing voting trust agreements.

In some cases the financially interested parties control directly because the voting trust agreement provides for annual meetings whereby holders of securities vote in proportion to the amount held and a majority directs the trustees to vote the stock.22 But usually the trustee is not controlled by the creditors at all, but merely represents them in the sense that their interests are the same or that collateral interests exist which make the trustee desire to serve the best interests of the creditor.23

which the corporation finds itself are due to mismanagement of the affairs of the company or to lack of adequate working capital, or to both.”

21 The holder of a voting trust certificate may not have the right to inspect the books of the corporation. It is also doubtful whether he can bring a shareholder's action against the corporation. In McHenry v. N. Y. P. & O. R. R., 22 Fed. 130 (N. D. Ohio, 1884), there was no adversion to the plaintiff's capacity to bring a shareholder's action as holder of a trust certificate when he joined his trustee as defendant, but relief was denied on other grounds. Voting trust certificates are subject to the stock transfer tax. Tax Law, N. Y. Ann. Cons. Laws (Cahill, 1923) c. 61, § 270; U. S. Radiator Corp. v. State, 208 N. Y. 144, 101 N. E. 783 (1913).


23 Clark v. Foster, 98 Wash. 241, 167 Pac. 908 (1917). The question arises as to the extent to which these interests in fact coincide. How far will the banker consider the bondholder's interest in the company as he would his own and act as a substitute for the group of scattered investors? The extent of that identity of interest will vary in different cases and at different times, and the best that can be done is to form some likely generalizations that will not necessarily be a description of any given case
As a result, in a reorganization case there is not likely to be majority rule in the form that we find it where there are 100,000 shares of common stock outstanding and control is in the hands of the owners of a majority of those shares. Two elements distinguish such a reorganization case from cases of normal corporate management. First, those in control only represent a financial interest instead of owning it as has just been pointed out; second, the stockholders may possibly have some equity in the failing corporation and so the trust agreement may result in some slight disproportionate exercise of power by the creditors. But it is very unlikely that this disproportion is going to be great enough in the ordinary reorganization case to raise the problem of minority control. This problem arises out of the supposed propensity of men to misuse power when they have nothing to lose thereby. This would presumably result in corporate mismanagement which the courts wish to avoid. But in these reorganization cases, those in control usually have an enormous claim, secured only by the genuine success of the corporation. Their interests and the interests of others in the corporation tend to be the same. In a corporation that has foundered, all parties are in the same boat until definite rehabilitation has been accomplished. It is usually certain that no dividends on stock can be paid, and whether or not interest can be paid on the bonds continues to remain uncertain for some time. While this state of affairs exists, both bondholders and stockholders are but will have some value as a probability. As a general rule the investment bankers who have purchased and marketed the bonds are made voting trustees. There is no doubt that before the bonds are sold to the public there is no minority control. There may be cases where large amounts of bonds are unmarketable and remain in the hands of the underwriting syndicate for a long period. But in most cases the bonds would quickly leave the hands of those in control and the question of fact as to whether the banker is going to act in the interest of his customers is raised. Daggett approves of voting trusts as used in railroad reorganizations, and in reference to the problem of representation of security holders he says that the voting trustees of the Baltimore and Ohio "seemed very ready to accord to new buyers that representation and influence to which their stock might give them claim." Daggett, RAILROAD REORGANIZATION (1903) 31. This indicates that voting trustees consider themselves real trustees since they accord privileges to stockholders which they could have taken to themselves or given to the bondholders. Cushing says that the bankers' "possible profits in controlling future underwriting is negligible as compared with the effect on their business of having incompletely managed a futile reorganization." Cushing, op. cit. supra note 1, at 33.

The consideration that investment bankers cherish their market and will try to back up their securities in case of threatened loss seems to justify the conclusion that in most cases the trustee represents the bondholders' interest in the corporation.

24 The Goodyear Tire and Rubber Company was reorganized in 1921 and made an unusually rapid recovery, due to a very favorable change in the
likely to be interested in one thing—making the enterprise income producing immediately. There is not likely to be any question as to whether capital surpluses are to be piled up or paid out in dividends; or whether earnings are to be funded or not. When the equity above the bonds is thin, conflicts of interest, which arise out of the difference in nature of stock and bond investments, are minimized.

Moreover in the usual reorganization case, as observation of some of the amounts involved will disclose, the equity of the stockholders, if any, is so small that there is no substantial separation of control from beneficial interest. The courts have little difficulty in upholding the voting trusts used in such cases.

2. Capital Raising. Likewise, voting trusts are legal if used to raise capital for a corporation in sound financial condition when the lenders will not take the risk without more control. Here again the question of whether the trustees will mismanage the company because of a lack of financial interest in it is not raised.

Simmons v. Atlanta T. & T. Co. is a memorandum opinion wherein it is stated that a voting trust determinable on the payment of a debt is valid. The case is expressly distinguished from Morel v. Hoge, where the Georgia court condemned a voting rubber market. Yet the common stock has earned no dividend up to date (April, 1927) although it has greatly appreciated in market value due to the improved condition of the company and the probability that dividends will soon be paid.

25 In Mobile & Ohio R. R. v. Nicholas, supra note 22, the total indebtedness was $15,650,000, which far exceeded the assets, the precise amount of which was not stated in the report. The capital stock was 53,206 shares which, assuming the par value to be one hundred dollars and assuming that the stockholders paid par value, would make the capital investment $5,320,000, which is only one third of the total indebtedness. Even if it is assumed that the stockholders had once invested five million dollars, their investment is probably worth little or nothing at the time of the reorganization.

The sum owed by the corporation to the group given control is usually very large. In Clark v. Foster, supra note 23, the creditors had invested $600,000 in bonds and had bought some preferred stock, the total capitalization being $3,000,000. In Ecker v. Kentucky Ref. Co., 144 Ky. 264, 138 S. W. 264 (1911), the liabilities were $195,000 over the assets, and the creditors contributed part of the $100,000 additional capital that was put into the company.


Voting trust cases cannot be classified by distinguishing between an attack by the cestuis and an attack by a minority stockholder. It makes no difference who sues. See Smith, op. cit. supra note 1, at 637, n. 16.

27 139 Ga. 488, 77 S. E. 377 (1913).
28 130 Ga. 625, 61 S. E. 467 (1908).
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trust involving minority control. In *Mackin v. Nicollet Hotel*, the plaintiff, a holder of voting trust certificates, sought to enjoin the voting trustees from voting the stock of a Delaware corporation doing business in Minnesota. The common stock had been put into a voting trust formed by the bank which had financed the enterprise. The court sustained the voting trust.

All these voting trusts are valid, not because of their seemingly good purpose or object, but because they do not involve minority control. As the court said in *Shelmerdine v. Welsh*, a very early case in the Pennsylvania inferior court:

“It matters not that the end [of the voting trust] is beneficial and the motive good, because it is not always possible to ascertain objects and motives, and if such a severance were permissible it might be abused. . . .”

The court held valid the voting trust involved in the case, which was one formed for the benefit of the creditors of the corporation, and said:

“They [the stockholders] are not the only persons beneficially interested in the railroad; the lien creditors are also owners, and, if harmony is not preserved, may possess the whole. . . . To decide that the election must be held exclusively on behalf of the owners of stock certificates would frustrate rather than give effect to the principle that votes should be cast by those who have substantial interest in the result.”

3. Other Voting Trusts. The use of the voting trust as a mere proxy to carry out some definite plan does not raise the problem of minority control. In *Bowditch v. Jackson Co.*, a voting trust for one year was formed to wind up the affairs of the company. The court found that a majority of the stock was in fact directly voted but declared in a dictum that a voting trust such as was involved in the case would be valid.

The voting trust can be used as a method of apportioning control among various groups so as to represent the interests of those groups in the corporation. The readjustment of the Interborough Rapid Transit Company in 1922 furnishes an excellent example of this application of the voting trust. The committees agreed on five voting trustees to whom the common stockholders of the Interborough transferred their stock in exchange for

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29 10 F. (2d) 375 (D. Minn. 1926).
30 20 Phila. 199, 201, 202 (Pa. 1899).
31 The raising of capital or reorganization must be the immediate purpose and cause of the voting trust. Mere statement of a purpose to raise capital in the future will not validate a voting trust otherwise invalid because it effects minority control at the time. *Harvey v. Linville Imp. Co.*, 118 N. C. 693, 24 S. E. 489 (1896); *Kreissl v. Distilling Co.*, 61 N. J. Eq. 5, 47 Atl. 471 (1900).
32 76 N. H. 351, 82 Atl. 1014 (1912).
voting trust certificates. The trust was to last for five years. The voting trustees were to elect the eighteen directors of the company but they were pledged to elect nine directors chosen by the voting trust certificate holders and preferred stockholders of the Interborough, three directors selected by bondholders of the Interborough, three directors selected by the New York City authorities, and three directors selected by the Manhattan Railway Company.

The Manhattan Railway Company had leased all its property to the Interborough for 999 years. This lease guaranteed to the Manhattan Company as rent, payment of all taxes on its property, interest on its outstanding bonds and certain dividends on its stock. The Interborough in effect owns the property of the Manhattan and the interest of the Manhattan stockholder in the Interborough is real and substantial.

Thus the voting trust in this case furthers instead of restricts majority control. It provides a means whereby financial interests traditionally not considered, as having any right to participate in management are given some control.

The voting trusts in all the cases thus far discussed do not in effect separate voting power from beneficial ownership of the corporation and they are, and should be, valid.

B. VOTING TRUSTS INVOLVING MINORITY CONTROL INCIDENTAL TO EFFECTING A SOCIALLY DESIRABLE END.

In this group of cases voting trusts result in minority control

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23 The city has refused to take part in the plan but the trustees, in filling the city's quota, have elected directors who would represent outside interests.

24 Voting trusts should be carefully distinguished from ordinary trusts of stock which of course incidently give the trustee the right to vote the stock. The purpose of such trusts is not to separate voting rights from beneficial ownership. Hall v. Merrill Trust Co., 106 Me. 465, 76 Atl. 926 (1910), is an interesting case involving this distinction. The plaintiff owned 590 shares and the Ames interest owned 892 shares of the stock of a lumber company. Their holdings together constituted a majority of the outstanding stock of the corporation. In order to prevent a rival lumber company, which was trying to get control, from buying either party's interests without buying both parties' interests, the plaintiff and Ames made over their shares to the defendant Trust Company. The Trust Company was to vote the stock as directed by a majority of a committee made up of the plaintiff, Ames and Wing (a disinterested third party). It was to sell the stock if a majority of the committee so directed. The plaintiff, acting secretly, bought out the rival company's interest and sought to get his stock back from the defendant Trust Company. Ames and Wing ordered the Trust Company to sell the stock pursuant to the agreement. The plaintiff's suit to enjoin the sale was denied, the court deciding that the agreement was not a voting trust, but a trust to sell the stock. See Venner v. Chicago City Ry., 258 Ill. 523, 101 N. E. 949 (1915) (a collateral trust); Robertson v. First Nat'l Bank, 35 Idaho 363, 206 Pac. 689 (1922) (similar to the Hall case, supra).
and thus raise the possibility that the corporation will be mismanaged, but the object of the voting trust in the particular case is so socially desirable that the courts will accept the minority control involved as a necessary evil, and will uphold the voting trust in the particular case even if, as general rule, they may consider the voting trust unlawful. Moreover, these voting trusts are usually limited to a short time, which fact serves to minimize any undesirable aspect they may have for courts condemning minority control.

In *Clowes v. Miller*, the voting trust was used to facilitate a sale of stock and the New Jersey court allowed the control to be separated from ownership while the sale was going on despite the court's definite antagonism toward voting trusts accomplishing minority control. In this case the plaintiff entered into an agreement with one Randolph whereby 2750 of the 4000 shares of the common stock of a certain corporation were transferred to the defendant trust company in trust to be voted at Randolph's direction for two years. In case the preferred stock of the company, to which Randolph had subscribed, was successfully marketed during that time, all the deposited common stock was to go to the plaintiff. In case Randolph did not succeed in selling the preferred stock, then 1875 shares of the deposited common stock were to go to the plaintiff and the remaining 875 shares were to go to Randolph. Randolph sold his interest to the defendant, Miller, who claimed Randolph's right to direct the trustee in voting the stock. The plaintiff sought to have the defendant, Miller, restrained from directing the trustee to vote the stock and to have the trustee enjoined to vote the stock as he, the plaintiff, directed.

The court held that the voting trust was valid because its formation had been primarily in pursuance of a sale of stock (the preferred) by the plaintiff to Randolph, but that Randolph's right to direct the trustee in voting the stock was a personal right and could not be transferred to Miller. Therefore neither Miller nor the plaintiff had the right to direct the defendant trustee to vote the stock, and the plaintiff's plea for the mandatory injunction was denied.

In *Frost v. Carse*, decided in 1919 by the Court of Errors and Appeals of New Jersey, a voting trust formed to prevent the stock of a corporation manufacturing submarines for the use of England during the war from falling into the hands of German agents was declared valid. The only object of the German agents in buying a controlling interest would be to interfere with the production of the corporation. This jeopardized the in-

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35 60 N. J. Eq. 179, 47 Atl. 345 (1900).
interests of all the stockholders. The court upheld the voting trust, but even in this case six judges out of the thirteen who constituted the court dissented. 37

There is some language in the decision of the Appellate Division of New York in the recent case of Tompers v. Bank of America 38 which indicates that a court might uphold a voting trust which is designed to prevent a rival group from getting control of the corporation. The main issue in the case was the validity of a voting trust in the special case of a bank and it involved the interpretation of the New York voting trust statute, but the court entered into some discussion of the problem at hand. This part of the opinion is not clear and it is uncertain whether the court was referring to a policy which would assist in preventing the corporation from falling into the hands of people whose interest it would be to wreck it, or whether it was justifying the voting trust because it tended to prevent the elimination of competition between rival groups.

It would seem that the assistance of the voting trust in enforcing the law against restraint of trade would be so meagre that courts which condemn voting trusts because they effectuate minority control should consistently condemn even those which tend to prevent the elimination of competition.

C. VOTING TRUSTS USED TO ACCOMPLISH AN ILLEGAL OBJECT

Thus far we have discussed voting trusts which are clearly valid either because they do not raise the problem of minority control at all or because they serve an end so useful in a particular situation as to outweigh the social policy (if any) which might tend to condemn them. Now we plan to discuss voting trusts which are clearly bad, not because there is minority control involved, but for other much more definite reasons based on well established principles of law.

37 A court otherwise antagonistic to voting trusts resulting in minority control will not be persuaded to uphold a voting trust designed merely to prevent stock from falling into the hands of a person characterized as a corporation wrecker in the voting trust agreement. There must be a real probability that the corporation will be ruined by those seeking to buy up control. See Bridgers v. First Nat'l Bank, 152 N. C. 293, 67 S. E. 770 (1910).

38 217 App. Div. 691, 217 N. Y. Supp. 67 (1st Dept. 1926). Judge Pros- kauer had enjoined the voting trustees from voting the stock at the suit of minority stockholders and voting trust certificate holders. The trustees appealed. The Appellate Division said in part: "As the object of these actions and the effect of the injunctions may be to open the way to a competing institution to engulf the defendant bank and its management, or to permit several speculators to embarrass the bank in the accomplishment of their designs, the orders should have at least awaited a trial." Supra at 694, 217 N. Y. Supp. at 71. This decision will be further discussed when the New York statute is considered infra note 61.
In this group of cases the use of the voting trust is incidental. If it is a crime to kill a man, then it is also a crime to kill him with a pistol. There is no adjudication on the legality of a pistol involved in such a case, as there would be in a case arising out of an indictment for the violation of the Sullivan law. It is patent that such cases should not be confused with cases where the legality of minority control is involved and where there is a totally distinct problem before the court. Yet the case most cited for the proposition that voting trusts are illegal is the *Shepaug Voting Trust Cases*, which is only an adjudication on a fraudulent transaction.

One Chapman and others bought a majority of the stock of the Shepaug Railroad and put it in trust to be voted at the direction of a committee, composed of himself and others. Chapman and other committeemen were interested in a certain construction company and the object of the purchase of the railroad stock and its control as above stated was to cause the railroad to build extensions that would result in advantageous contracts with their firm. The suit arose on the occasion of a demand by a holder of a large number of trust certificates to have the agreement declared void and his stock returned. The court so decreed on the ground that there was involved actual fraud of the kind of which equity courts have always taken notice and that the purpose of the agreement was therefore illegal. The court's statement that the voting trust was invalid because it involved a separation of control from beneficial interest in the corporation was in no way called for by the facts of the case.

D. VOTING TRUSTS EFFECTUATING MINORITY CONTROL

Having cleared the field, we now come to a consideration of the legality of voting trusts used to effectuate minority control; or in other words, the attitude of the courts on the social policy involved in the separation of control from the beneficial ownership of stock, accomplished by the device of the voting trust.

*Smith v. San Francisco & N. P. Ry.*, decided by the Supreme Court of California in 1897, is one of the earliest cases on the subject and is often cited for the proposition that voting trusts are valid. The plaintiff in this case entered into an arrangement with two others whereby they all bought a block of stock and made a written contract that the vote of the whole block was to be cast as the majority of them decided for a period of five years. They agreed to retain the voting power if they sold the stock.

30 60 Conn. 553, 24 Atl. 32 (1890).
41 115 Cal. 584, 47 Pac. 582 (1897).
The plaintiff repudiated the agreement and demanded the right to vote the stock at a corporate election, but his vote was refused because of the contract. The plaintiff sought to set aside the election and to compel the corporation to accept his separate vote.

The court upheld the agreement and denied the plaintiff relief. It said that the purpose of the agreement was legal—to vote the stock in the best interest of the corporation. By that it meant that there was no immediate illegal object as in the Shepaug case, to which it referred in the opinion. The court pointed out that there were no third parties involved in the transaction.

An important point to notice in this case is the fact that the parties made up the agreement and then went in and bought the stock, relying on the arrangement to vote the stock as a unit. This involves two important considerations: first, a change of position by the parties after the agreement; second, a situation that looks like a partnership. The court keeps talking about the fact that there was consideration for the contract and it was not thinking about the body of law which makes promises absolutely unenforceable unless they motivate one another. It was thinking about the added element of change of position.

This is wholly unlike the typical voting trust agreement where the parties already own stock and then go into the agreement for the purpose of concentrating control, but with no substantial change of position.

Moreover, the three parties went into the common project of purchasing stock and the vote pooling can be considered incidental to that. The fact that the shares were issued to them as individuals should not alter the essential character of the enterprise, which looks very much like that of a partnership.

When we analyze the case in this manner we come very close to the situation in Hey v. Dolphin,42 decided by the New York Supreme Court in 1895. The plaintiff and the defendant having launched a corporation, took out a joint certificate for 2000 shares of common stock, agreeing between themselves to own it as tenants in common and agreeing with the corporation and with each other that neither would sell his share without the consent of the other. The plaintiff gave the defendant a power of attorney to vote the stock for ten years. The plaintiff sued to have an individual certificate issued to him and to prevent the defendant from voting his share of the stock. The court refused to comply with the plaintiff's demands. They said that the transaction was clean and fair, made the point that there

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was consideration and finally said that it was a partnership agreement.

The New York case differs from the Smith case in that there is an express agreement in the former that neither party will sell without the consent of the other. In the Smith case the power of sale without voting power is expressly reserved. This might have resulted in the stock getting into the hands of parties other than those in the agreement, without voting power. But the holding in the Smith case is essentially very weak at best, for the reasons stated.

Brightman v. Bates,\(^4\) decided by the Supreme Court of Massachusetts in 1900, with an opinion written by Mr. Justice Holmes, is often cited as upholding the voting trust. The plaintiff sued on a covenant whereby he was to get certain commissions from the defendant if certain stock was subscribed for and purchased from the defendant. The subscribers subsequently agreed among themselves to have the stock issued to a trustee, to be voted as directed by a committee of five representing the subscribers for three years.

The defendant claimed that this dealing with the stock was illegal and voided the agreement with the plaintiff. The court allowed the plaintiff to recover on the ground that the agreement on which the plaintiff sued was probably not sufficiently closely connected with the voting trust agreement to be invalidated, even if the voting trust was void. Then the court went on to say that the voting trust was legal.

Aside from the fact that any adjudication on the voting trust was the weakest kind of dictum, the court itself having placed the decision expressly on the first ground, here, again, the problem of the regular voting trust was not presented to the court by the facts of the case.

No one with a legitimate interest in the corporation is complaining. A man was trying to break, after complete execution by the other party, what appeared to be the most harmless sort of a contract. The stock had not yet passed out of the hands of the owners so as to create a class of people without any rights whatsoever, not even the meagre one of voting for the committee. The voting trust was to last but for a short time—three years—whereas the typical voting trust designed to effect minority control lasts for ten or twenty years or more. The facts of the case do not even support the dictum.\(^5\)

\(^4\) 175 Mass. 105, 55 N. E. 809 (1900).

\(^5\) However, a recent Massachusetts case assumes the legality of a voting trust on the authority of the Bates case. Bullivant v. First Nat'l Bank, 246 Mass. 324, 141 N. E. 41 (1923). But the facts of the case take it out of the minority control group since the voting trust was formed because
In Boyer v. Nesbitt, the Pennsylvania Supreme Court has probably upheld the voting trust even when it is used to effect minority control. Here the stock was transferred to trustees for the general purpose, according to the agreement, of securing efficient management of the corporation. The plaintiff was a purchaser of a certificate of trust. The court generally questioned the wisdom of a policy which would condemn voting trusts but concluded that, in the case before it, the provision in the agreement whereby the trustees were to have the right to buy the stock from anyone wishing to withdraw was "the turning point of the case." The court said that the trust was therefore coupled with an interest, the option to buy, and they denied the plaintiff the right to vote the stock represented by the certificate.

It seems, however, that the talk about the option was really a make-weight argument. An option to buy the stock at ten times its market value could be written into every voting trust agreement. It seems that the Pennsylvania courts have passed on the question of voting trusts and have decided in their favor on the merits, unless future courts reverse the Boyer case as a protest against the reasoning in the opinion.

In the same year, 1910, the Virginia court decided in favor of the voting trust when it was fairly faced with the problem of minority control by the facts of the case of Carnegie Trust Co. v. Security Life Ins. Co. The plaintiffs, holding stock and trust certificates together constituting a majority in interest in the corporation, filed a bill in equity to have the voting trust declared void. The voting trust had been formed when the corporation was first organized and it was to last for twenty-five years. The appellate court affirmed this decision saying, in part:

"Under the recent and advanced decisions it may be asserted as the prevailing doctrine that a pooling trust created by a deposit of stock certificates for a specified period of time with the authority to vote the same for the benefit of the owners and to the best interests of the corporation... is legal."

of the embarrassed financial condition of the corporation and the voting trustee was a large creditor.

227 Pa. 398, 76 Atl. 103 (1910). This seems to overrule the dictum in the case of Shelmerdine v. Welsh, supra note 30.

The term "voting trust" is used here and hereafter to designate the type of voting trust used to effectuate minority control, unless the contrary is indicated.

See Foll's Appeal, 91 Pa. 434 (1879), decided just after the panic of that year. The Pennsylvania court there refused to grant specific performance of a contract of sale of bank stock to give control of the bank, questioning the social value of control of such institutions by individuals and small groups.

111 Va. 1, 68 S. E. 412 (1910).

Supra note 48, at 21, 68 S. E. at 418 (1910).
On the other hand the New Jersey courts, after some hesitation, have finally condemned the voting trust. The last direct decision, in Warren v. Pim, resulted in a vote of seven to six on the issue of the illegality of the voting trust involved in the case. The plaintiff, as owner of both stock and voting trust certificates, sued to enjoin the voting trustees from voting the stock and to compel them to transfer the stock certificates to him. The voting trust was to last for fifty years or until three quarters of the certificate holders elected to terminate it. The court granted the plaintiff's bill.

Judging from the very old decision of Moses v. Scott, in 1888, Alabama seems to be against the voting trust, while Georgia has definitely condemned it in the case of Morel v. Hogc, as have North Carolina, and Michigan.

Luthy v. Ream definitely decided the fate of the voting trust in Illinois in 1915. The plaintiff in that case owned a few shares represented by voting trust certificates and also a block of minority stock not included in the voting trust. The court decided that the voting trust transgressed both types of interests.

The Illinois courts have been particularly averse to the modern practice of separating voting power from the beneficial ownership of stock. Even Ripley could not desire more thoroughgoing condemnation. In People v. Emmerson, they went so far as to say that preferred stock without the right to vote could not be issued by an incipient corporation. The court held that all stock must be given the right to vote under the statute and the constitutional provision which read as follows:

"... Every stockholder shall have the right to vote, in person or by proxy, for the number of shares of stock owned by him, for as many persons as there are directors or managers to be elected, or to cumulate such shares and give one candidate as many votes as the number of directors multiplied by the number of shares of stock shall equal ...\)
As far as decisions are concerned, the law of voting trusts can hardly be said to be thoroughly formed. The courts have not taken a definite stand on the matter one way or the other in more than six or seven jurisdictions. What little law there is is definitely in the direction of illegality.

Eight states including New York and Delaware have passed statutes legalizing voting trusts for a stated period. These statutes are far from settling the law. As yet there are no important adjudications under them to fix their meaning. They could well be restricted by hostile courts to apply only to reorganization, creditor, special counter-balancing advantages, etc., situations, and be held to be merely declaratory of the common law on these subjects.

60 N. Y. Ann. Cons. Laws (Cahill, 1923) c. 60, § 50: "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 upon the terms and conditions therein stated. Every other stockholder may transfer his stock to the same trustee or trustees and thereupon shall be a party to such agreement. The certificates of stock so transferred shall be surrendered and canceled and new certificates therefor issued to such trustee or trustees. . ." Ark. Cons. Laws Ann. (Castle, 1927) § 17001 (five years); Del. Laws (1925) c. 112, § 6 (ten years); Fla. Cum. Stat. (1925) § 4120 (19) (ten years); Md. Code (Bagby, 1924) art. 23, § 133 (five years); Nev. Stat. (1925) c. 177, § 22 (five years); N. J. Acts 1926, c. 318, § 5 (ten years); Ohio Gen. Corp. Act (1927) § 34.


61 There is a dictum to the effect that certain voting trusts will be held invalid despite the statute in Knickerbocker Inv. Co. v. Vorhees, 100 App. Div. 414, 91 N. Y. Supp. 816 (1st Dept. 1905). The excellent opinion of Judge Proskauer in the special term hearing of the case of Tompers v. Bank of America, supra note 38 (Nat'l Liberty Ins. Co. v. Bank of America, 126 Misc. 753, 214 N. Y. Supp. 643 (Sup. Ct. 1926) ) shows the unsettled state of the law under the statute. Judge Proskauer held that the statute did not change the law, at least in some respects. In that case a majority of the stock of a bank was transferred to voting trustees, some of whom, it was alleged, were officers of the bank. The trust was to last for ten years. Certificates were issued to the cestuis. There was provision made in the agreement for filing, etc., to comply with the New York voting trust statute (supra note 60). The plaintiffs held minority stock and voting trust certificates and they sued to enjoin the voting trustees from voting the stock represented by their trust certificates. The principal question in the case was whether the agreement was entered into before March 12, 1925, when an amendment to § 50 was adopted which expressly excluded banks from its provisions. Judge Proskauer's decree granting an injunction pendente lite was reversed by the Appellate Division, which disagreed with his application of the amendment to the facts of the case and also disagreed with his outlook on the general law of voting trusts. The court's treatment of the common law was incidental and it leaves the legal status of voting trusts very uncertain. See supra note 38. The whole opinion may be taken as a denial of the injunction pendente lite only, and as not passing on the merits at all.
down the common law right to form a voting trust for purposes other than minority control to the statutory period.\textsuperscript{62}

II.

Class A, non-voting stock, raises in a different manner the same problem of the social policy of minority control. But, in contrast to the voting trust situation, the present law is quite clear that non-voting stock can be legally issued except in Illinois where, in the absence of other provision in the statutes, the cumulative voting provision resulted in an adjudication that no stock can be issued without voting power.

While there are to the writer's knowledge no decisions on the subject, practically all the statutes by implication permit the deprivation of stock of voting power on issuance. Some statutes, like New York's, expressly allow corporations to limit voting power as they please in this regard. There is always the possibility of these statutes being construed to apply only to stock with a fixed income (preferred) but this is unlikely. Any change in the legal status of non-voting stock would have to come as a result of legislative enactment.

As a device for securing minority control, the voting trust would seem less objectionable than non-voting stock. The voting trust must start with majority control. The stockholder is given the power and then freely alienates it, having made a free decision that the voting trust is for his best interest.

This fact is not as important as it may appear, however, because, if there is water in the capital structure of the corporation, as there often is, the holders of the stock issued for the inflated valuation form the voting trust and then sell the trust certificates to the real investor.

More substantial is the argument that, in the voting trust, responsibility is fixed in a small definite group, likely to be known by all the other stockholders and by anyone interested in the corporation.\textsuperscript{63} There is less likelihood of misconduct in this situation than there is when the same control is exercised by individuals as stockholders. The psychology of the situation is different.

Outside of these differences in the manner in which the devices work, there is no other distinction between them in the problem involved, which is that of the social policy of allowing or disallowing, as far as possible, minority control of corporate enterprise.

Whenever the courts pass on this problem they really decide

\textsuperscript{62} See Note (1925) 25 Col. L. Rev. 951.

\textsuperscript{63} "The advantages to all concerned of a responsible management which is publicly held accountable for its trust are too obvious to require comment." 3 Dewing, op. cit. supra note 19, at 152.
The broadest kind of a sociologic question:—Is it probable enough that the absence of proportionate financial interest will result in fraud or misconduct in the management of our huge corporate enterprises so that we should treat the matter as if it were directly intended and prevent the separation of power from ownership at the outset?

The courts do not hesitate to answer the question in the affirmative when a stockholder’s vote is purchased either with cash or by handing him an office in the corporation or by giving him a contract right in exchange. The common law, as well as modern statute law, forbids the purchase and sale of the right to vote stock. We are generally committed to the proposition that this would be a harmful practice because of the high probability that such transactions will result in fraudulent and ineffectual corporate management.

But on the question of control, unpurchased and not entirely separate from a legitimate interest in the corporation such as the voting trust or non-voting stock involve, it is much more difficult to pass. The method of attacking such a problem is thorough-going research into the facts of corporate organization, corporate control and corporate activity. It would involve the collection and study of data on the proportion of unsuccessful corporations which fail because of inefficient or corrupt management, the social effects of such failure, and the effect of the elimination of such failures, where possible, on the economic structure of society. It would involve an inquiry as to what persons control what corporations and an understanding of their financial and social standings (to determine the question of whether it would be to their ultimate interests to mismanage the corporations they control). In short, it would require the same kind of approach that the successful solution of any social problem demands—an intensive study of the phenomena and tabulation and correlation of the resulting data.

The factors that would be discovered to set over against the possibility of abuse would probably be: first, continuity of management, with the advantages that flow therefrom, such as the formation of personal connections, increasing familiarity with the details of the business and the like; second, unvacillating, long-time policies.

The fact previously noted, that in most corporations to-day the stock is widely held and that consequently there is control by the compact minority, may throw some light on the problem. However, it must be remembered that although somewhat similar, the situation is not the same and an essentially distinct problem is involved because the controlling group usually owns a substantial block of stock, some of which, at least, probably represents real investment. Also, there is always the possibility
of overturning the management if it becomes obviously bad as respects the interest of the majority. In some cases this check on the controlling minority is a real force, compelling them to act fairly. In general the force may not be very real, but it may have the effect of continually causing the controlling minority to seek to justify its management as a result of its imaginary fears.\footnote{\textsuperscript{64}The writer has been informed of one instance where a corporation had originally issued and widely marketed non-voting stock. For special reasons it was decided to give voting rights to the non-voting stockholders. As a result, the management thought it necessary to make numerous alterations in the charter at great additional inconvenience and expense in order to safeguard themselves against the outstanding voting power that they were about to create.}

Moreover, it may be said that the law has accepted this kind of minority control as a fact and has developed along lines which result in throwing fundamental safeguards around the interests of those out of power. This development prevents flagrant abuse of any kind of power in corporate management. When actual fraud is involved or when those in control violate well recognized property rights, the law gives relief, no matter what arrangements the parties have made among themselves as to the control of the corporation. The by-laws cannot be amended so as to alter substantially the rights of stockholders; a prosperous corporation cannot be sold out; obviously unfair dividend policies cannot be pursued.\footnote{\textsuperscript{65}See Berle, \textit{op. cit. supra} note 1, at 679.}

But when the matter of management policy is alone involved, the courts have definitely refused to interfere, and the stockholder's vote is his only recourse. Whether we should allow him to purchase an ownership interest in the corporation without such a power, or whether we should allow him to give away that power, is a question that can be intelligently answered, not by the aid of political theory which the courts tend to use as a result of the history of the corporation, but by an inquiry into the sociological and economic factors involved.