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Corporations -- Specific Enforcement of Shareholder Agreements

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refusing altogether to assess such damages." Moreover, if the defendant wrongfully discharges the plaintiff, he should be taken to have understood that if he did not wish to be subjected to such damages, he should have kept his agreement.

It is submitted that the court in Freeman was correct in recognizing the inadequacies of the Smith and Robinson decisions. The court has now set the stage so that in the next case raising the issue counsel should present the reasons supporting the majority rule which allows damages for the entire contract period. When this occurs the court will probably adopt the sounder majority rule.

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Corporations—Specific Enforcement of Shareholder Agreements

Shareholder voting agreements to achieve control of a corporation are generally recognized as lawful. Difficulty arises, however, when a shareholder breaches a voting agreement, and the court is faced with the dilemma of awarding the inadequate relief of money damages, or specifically enforcing the agreement, thereby substituting the court's direction for the will of the majority.

10 LABATT § 363(e), at 1145.
20 E.g., Granow v. Adler, 24 Ariz. 53, 206 Pac. 590 (1922); Seymour v. Oelrichs, 156 Cal. 782, 106 Pac. 88 (1909); Carter v. Gillette, 163 Mass. 95, 39 N.E. 1010 (1895).

Voting agreements should be distinguished from voting trusts. Voting trusts are created by the transfer of shares to trustees, who vote these shares as dictated by the agreement. Statutes now usually control both the formation and duration of these agreements. If a voting trust is inconsistent with the statute it is generally held void. Voting agreements are contracts among shareholders to vote stock in a specified manner. Typically, statutory control is not present. HENN, CORPORATIONS §§ 199-200 (1961).


Courts often recognize the legality of shareholder agreements in a negative manner, by stating that the "contract is not per se invalid." For a collection of such cases see Annot., 45 A.L.R.2d 799, 802-04 (1956). See Generally 5 FLETCHER, CYCLOPEDIA CORPORATIONS § 2064 (perm. ed. rev. repl. 1952).

Compare E.K. Buck Retail Stores v. Harkert, 157 Neb. 867, 62 N.W.2d
In *Weil v. Berseth* the shareholders of a close corporation agreed to elect each other directors. The by-laws were to be amended to provide one seat on the board of directors for each of the four shareholders, with no further amendments to "by-laws so adopted" except by unanimous consent. Ten years later, in 1965, three of the shareholders voted to adopt new by-laws increasing the membership of the board of directors to five, and allowing amendments to by-laws by a majority vote of the board. The fourth shareholder objected and sued for specific enforcement of the agreement. The court held that plaintiff was entitled to an injunction ordering a stockholders' meeting to be called, at which the defendants would vote their stock: (1) to re-enact the repealed by-laws, (2) to repeal by-laws inconsistent with the original agreement, (3) to remove from the board of directors the power to amend certain by-laws. The court further indicated that plaintiff was entitled to injunctive relief to preserve the status quo, and if it seemed necessary, to injunctive relief requiring that the added director resign.

Two problems pervade most voting agreement disputes: legality of the contract and, more perplexing, the remedy available in case of breach. Courts of equity traditionally have refused to spe-

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288 (1954) (implication that money damages could be awarded), with Ringling v. Ringling Bros.-Barnum & Bailey Combined Shows, 29 Del. Ch. 318, 49 A.2d 603 (Ch. 1946) (granting specific performance).

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See note 1 supra. Some cases invalidate these agreements because they sever ownership from voting control and are thus contrary to the corporate norm of rule by majority vote. Additionally, it has been argued that the party voting the stock might not be interested in the corporation's welfare. See, e.g., Palmbaum v. Magnusky, 217 Mass. 306, 104 N.E. 746 (1914); Roberts v. Whitson, 188 S.W.2d 875 (Tex. Civ. App. 1945).

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Mutual promises most often serve as consideration in such contracts, but at least two courts have indicated a need for consideration in addition to mutual promises to gain specific enforcement. See, e.g., Johnson v. Spartanburg County Fair Ass'n, 210 S.C. 56, 41 S.E.2d 599 (1947); Roberts v. Whitson, 188 S.W.2d 875 (Tex. Civ. App. 1945).

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If a proxy is revocable there can be no specific enforcement since the parties could withdraw at will from the contract. Proxies are generally said to be revocable unless coupled with an interest. 5 *Fletcher, Cyclo-

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pedia Corporations* § 2062 (perm. ed. rev. repl. 1952). This reasoning which developed from Mr. Chief Justice Marshall's decision in *Hunt v. Rousmanier's Adm'r*, 21 U.S. (8 Wheat.) 174, (1823), has proven to be an inadequate basis for finding irrevocable proxies. See, e.g., *Smith v. San Francisco & N.P. Ry. Co.*, 115 Cal. 584, 47 Pac. 582 (1897) (court found
specifically enforce such agreements.⁹ Such reluctance can be traced to a narrow concept of the judicial power available for enforcement⁸ and to certain norms concerning the proper form of corporate operations.⁹ Recent cases, however, indicate an evolving favorable attitude toward specific enforcement.¹⁰ Courts have begun to recognize the problem of applying laws designed primarily for large publicly-held corporations to closely-held corporations. The result has been a liberal interpretation of corporation law to enable close corporations

an implied agency on the part of the non-defaulting party to a shareholder agreement to vote the shares of the defaulting party; this was coupled with reliance on the agreement to hold the proxy irrevocable). One commentator suggests that "[S]pecific performance of voting agreements . . . should depend neither on the finding of an elusive 'interest', nor on the creation of a fictional implied agency. Rather, the criterion . . . should simply be its appropriateness as a remedy in a specific case." 15 U. CHI. L. REV. 738, 743 (1948). Statutes adopted in some states have been used to clarify the nature of the interest needed to uphold irrevocable proxies. See Folk, Revisiting the North Carolina Corporation Law: The Robinson Treatise Revisited and the Statute Reconsidered, 43 N.C.L. REV. 768, 825 (1965).

⁷ FLETCHER, CYCLOPEDIA CORPORATIONS § 2067 (perm. ed. rev. repl. 1952). But see, 15 U. CHI. L. REV. 738, 743 & n.27 (1948) (questioning the rule that courts of equity will not specifically enforce shareholder agreements).

See, e.g., Haldeman v. Haldeman, 176 Ky. 635, 651, 197 S.W. 376, 383 (1917) (dictum) where the court indicated that equity will not specifically enforce where to do so will create complicated and difficult problems. [A] court of equity will not undertake the specific performance of a contract which is impossible of performance. If a contract be treated as valid . . . difficult questions must arise in its enforcement. As an instance: Has the court power to direct stockholders how they shall vote in their selection of directors, and can it instruct directors how to vote in the election of officers to the corporation?

Ibid.

⁸ The problem with these entrepreneurs [close corporations] . . . is to reconcile . . . aims with corporate norms which have been so often stated as prerequisites of corporate existence. These norms—originally formulated to protect the investing shareholder in large corporations—include control of corporate activities by a board of directors, rule by majority vote, free transferability of ownership shares, and continuity of organizational life not terminated by the death or withdrawal of a participant.

Hornstein, Stockholders Agreements in Closely Held Corporations, 59 YALE L.J. 1040 (1950). See also Gage v. Fisher, 5 N.D. 297, 303, 65 N.W. 809, 811 (1895) (dictum). This case implies denial of specific performance where a shareholder agrees to surrender his right to control corporate activities to another party.

¹⁰ See, e.g., Smith v. San Francisco & N.P. Ry. Co., 115 Cal. 584, 47 Pac. 582 (1897); Ringling Bros.—Barnum & Bailey Combined Shows v. Ringling, 29 Del. Ch. 318, 49 A.2d 603 (1946); Galler v. Galler, 32 Ill. 2d 16, 203 N.E.2d 577 (1964); Katcher v. Ohman, 26 N.J. Super. 28, 97 A.2d 180 (1953); Baren v. Baren, 59 Pa. D. & C. 556 (C.P. 1947). Few cases hold explicitly that specific enforcement of a shareholder voting agreement is available as a remedy. Most decisions are not directed toward this question, but focus on injunctive remedies.
to operate with many of the characteristics of partnerships. The courts have "relaxed their attitudes concerning statutory compliance when dealing with close corporation behavior, permitting 'slight deviations' from the corporate 'norms' in order to give legal efficacy to common business practice."¹¹ Some states have adopted statutes focused directly at close corporations, or at least favorable to their operations.¹² Wyoming has enacted a unique statute which provides for the specific enforcement of shareholder agreements.¹³

Given the goal of many shareholder agreements—to bring partnership attributes to close corporations—specific enforcement presents a quandary. If the court enforces such an agreement the shareholders are pressed into a judicially enforced intimacy contrary to a basic principle of partnership law, that of dissolution at will.¹⁴ A forced relationship produces friction among the parties, and is not conducive to the efficient operation of the enterprise. Further, if a personal service contract is involved, and a party wishes to withdraw from the agreement, the requirement of specific performance approaches involuntary servitude.¹⁵ Conversely, if the court fails to specifically enforce shareholder agreements, there being no other adequate remedy, the advantages of operating as a partnership are lost.¹⁶ Also informal agreements carried over into the in-

¹¹Galler v. Galler, 32 Ill. 2d 16, 29, 203 N.E.2d 577, 584 (1964).
¹²See, e.g., ILL. ANN. STAT. ch. 32 § 157.33 (Supp. 1965); FLA. STAT. ANN. §§ 608.0100-.0107 (Supp. 1965); N.C. GEN. STAT. § 55-73(b)(c) (1965); N.Y. BUS. CORP. LAW § 620.
¹³In an action by a shareholder who is a party to such an agreement a court of competent jurisdiction may enjoin another party or parties to such agreement from voting his or their shares in violation thereof, and the court may, in an action to which the corporation is a party by appropriate decree set aside an election of directors or other action resulting from the voting of shares in violation of such agreement, and in addition the court may grant such other or further relief as is appropriate under the circumstances for the enforcement of such agreement. WYO. STAT. ANN. § 17-36.31 (1965). See also CONN. GEN. STAT. REV. § 33-339(b) (1961); TEX. BUS. CORP. ACT art. 230(b) (Supp. 1966).
¹⁴UNIFORM PARTNERSHIP ACT § 31.
¹⁵But see In the Matter of Staklinski, 6 N.Y.2d 159, 160 N.E.2d 78, 188 N.Y.S.2d 541 (1959) where specific enforcement of an employment contract was granted.
¹⁶These advantages may include "[P]ower to allocate managerial authority in line with the talents of the owners and the dictates of their business and financial bargain; to assure each participant a share of the fruits which corresponded to his contribution, not only of funds but, of energy and managerial ability; to permit a considerable degree of choice of business associates." Chayes, Madame Wagner and the Close Corporation, 73 HARV. L. REV. 1532, 1534 (1960).
corporated partnership are dissolved, and formal methods such as voting trusts must be used to maintain these former arrangements.17

Although most commentators and some recent cases have recognized the necessity for specific enforcement if the agreement is to be effective,18 relatively few cases directly deny or grant,19 as did Weil, specific performance. Ringling Bros.-Barnum & Bailey Combined Shows v. Ringling20 and Abercrombie v. Davies,21 both decided by the Supreme Court of Delaware, are perhaps the leading cases in the United States dealing with shareholder voting agreements; yet in neither case was the issue of specific performance directly decided. In Ringling instead of enforcing the agreement the Delaware Supreme Court merely disallowed the votes of shareholders breaching it.22 The same court in Abercrombie held the agreement invalid because it was in substance a voting trust and failed to comply with statutory requirements.23 By refusing to face the issue, both cases denied specific enforcement and thereby upheld the old common law rule. The court in Ringling has been criticized for ignoring the intent of the parties as manifested by the agreement24 and for discouraging the use of voting agreements by confusing prospective parties to such contracts on what remedy would be available on breach,25 but the decision might be explained

18 E.g., HENN, CORPORATIONS § 200 (1961).
20 29 Del. Ch. 610, 53 A.2d 441 (Sup. Ct. 1947), reversing 29 Del. Ch. 318, 49 A.2d 603 (Ch. 1946). Two of the three shareholders of a close corporation entered an agreement to vote their stock together to achieve control of the corporation. Any disputes were to be submitted to an arbitrator whose decision on the manner in which votes were to be cast was to be binding on both parties. When one shareholder refused to vote as directed by the arbitrator, a suit for specific performance of the agreement resulted.
21 36 Del. Ch. 371, 130 A.2d 338 (Sup. Ct. 1957), reversing 36 Del. Ch. 102, 125 A.2d 588 (Ch. 1956); 35 Del. Ch. 599, 123 A.2d 893 (Ch. 1956); see 34 N.Y.U.L. REV. 961 (1959). Shareholders of the majority of stock of a corporation agreed to execute an agent's agreement under which they could gain control of the board of directors. This was achieved by providing that seven of the eight agents could cast the votes of the whole block, and that disputes would be arbitrated. The action arose when shareholders who were not parties to the agreement moved to have the agreement declared invalid because it placed control in the minority of the board, and made the board a mere sham.
22 29 Del. Ch. 610, 624, 53 A.2d 441, 448 (Sup. Ct. 1947).
24 LATTIN, CORPORATIONS 320 (1959).
by the court's reluctance to force parties into a relationship which they no longer desire.\footnote{Chayes, Madame Wagner and the Close Corporation, 73 Harv. L. Rev. 1532 (1960).} The result in Abercrombie was the same as in Ringling, and both cases have clouded the issue of specific enforcement.

Part of the confusion may be traced to the fact that both cases reversed well-reasoned decisions by a progressive court of chancery. In Ringling, Chancellor Seitz, argued that specific performance was the only equitable remedy, and that denial of this remedy would make the agreement invalid.\footnote{29 Del. Ch. 318, 335, 49 A.2d 603, 611 (Ch. 1946).} This is similar to the reasoning in Weil that money damages were inadequate and that specific performance would lie.\footnote{35 Del. Ch. 599, 621, 123 A.2d 893, 905 (Ch. 1956).} In Abercrombie, ten years later, Chancellor Seitz found a valid pooling agreement,\footnote{In re Farm Industries, 41 Del. Ch. 379, 196 A.2d 582 (Ch. 1963).} and most recently, in 1963 he specifically enforced an agreement to form a voting trust.\footnote{32 Ill. 2d 16, 203 N.E.2d 577 (1964), reversing 45 Ill. App. 2d 452, 196 N.E.2d 5 (1964).} Thus the Court of Chancery has been one of the leading advocates of the specific enforcement of voting agreements. Neither Weil nor the leading Delaware cases engaged in any policy discussion on specific enforceability beyond stating that that remedy was the most "adequate or equitable" and should be awarded. It may be conjectured that these cases were based on policy considerations similar to those expressed by the Supreme Court of Illinois in Galler v. Galler.\footnote{Id. at 27, 203 N.E.2d at 583-84. Two brothers owner 95% of the stock. An agreement was executed which provided for equal control for each family on the death of either brother. One of the brothers died, and the other brother and his family refused to abide by the agreement. The widow sued in equity for an accounting and for specific performance. The

While the shareholder of a public-issue corporation may readily sell his shares on the open market should management fail to use, in his opinion, sound business judgment, his counterpart of the close corporation often has a large total of his entire capital invested in the business and has no ready market for his shares should he desire to sell. He feels, understandably, that he is more than a mere investor and that his voice should be heard concerning all corporate activity. Without a shareholder agreement, specifically enforceable by the courts, insuring him a modicum of control, a large minority shareholder might find himself at the mercy of an oppressive or unknowledgeable majority.\footnote{id. at 27, 203 N.E.2d at 583-84. Two brothers owner 95% of the stock. An agreement was executed which provided for equal control for each family on the death of either brother. One of the brothers died, and the other brother and his family refused to abide by the agreement. The widow sued in equity for an accounting and for specific performance. The
Once a court decides to grant specific performance, there remains one other problem—the proper scope of the remedy. In Ringling and Galler the Court of Chancery went no further than simply indicating that specific performance was proper. Weil did not stop at this but actually directed shareholders to vote in a certain manner to carry out the agreement. Such broad instructions may seem to be an over-extension of the principles of specific performance since courts will not normally direct the manner in which shareholders are to vote their stock. The instant case, however, only represents the natural extension of all cases indicating that shareholder voting agreements are specifically enforceable. The voting directions given by the court did not require anything other than that which would have been necessary under a simple decree of specific performance. Further, by indicating the exact method for performing the agreement, additional litigation may be avoided.

Weil, by specifically enforcing the agreement extended the functional advantages of partnership management to the corporation, but was unable to simultaneously provide, as does partnership law, a method of free dissolution. The two goals are incompatible. The pragmatic solution is to recognize that partnership law cannot, and perhaps should not, be carried over in its entirety into the close corporations. Each decision must be based on a factual analysis of the case, and not on inflexible rules of law. Specific enforceability of shareholder voting agreements must ultimately be a question of judicial discretion.

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Criminal Law—Psychiatric Examination of Prosecutrix in Rape Case

Most jurisdictions follow the common law rule that a defendant charged with rape may be convicted solely upon the uncorroborated