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The Constitutionality of Classifying Corporate Directors in Pennsylvania

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THE CONSTITUTIONALITY OF CLASSIFYING CORPORATE DIRECTORS IN PENNSYLVANIA

Recent developments in the field of Corporation Law have cast doubts upon the constitutionality of Pennsylvania's statutory provision for classification of directors. Section 403 of the Business Corporation Law of 1933 provides that:

> "If the articles or by laws of a business corporation so provide, the directors of the corporation may be classified in respect to the time for which they shall severally hold office . . . ."[1]

This is a slight modification of the *Act of* 1887[2] which permitted classification of directors by a majority vote of shareholders without requiring the articles or by-laws to provide for such classification. Thus, classification of directors has been permitted in one form or another ever since 1887. This is so, even though the Constitution of 1874, as reiterated in the Business Corporation Law of 1933 makes cumulative voting mandatory.[3] Standing side by side for sixty-eight years, these two provisions have not been overruled even though they are inconsistent.

The purpose of cumulative voting is to give minority shareholders representation on the board of directors and thus serve as a check on majority control.[4] But, when directors are classified, the benefits derived from cumulative voting are emasculated. For example, on a five man board of directors, under cumulative voting a minority holding only one-fifth of the shares is practically assured representation. But, if this same board is divided into two classes, one consisting of three directors and the other two, one-third of the shares would be required for the same assurance.

In the recent case of *Wolfson v. Avery*[5] the Supreme Court of Illinois was faced with a constitutional provision guaranteeing cumulative voting and a statutory authorization of classification of directors. The latter was declared to be unconstitutional. This provision gave stockholders the right to vote for ". . . as many persons as there are directors or managers to be elected . . . ."[6] The appellants argued that "to be elected" referred to those elected at that particular time, rather than to the entire board and thus less than the whole board could be elected at one time. The court disagreed. In refusing to accept the meaning of the words "to be elected" ascribed to them by the appellant, the court relied on another sentence of the same constitutional provision which gave the right, ". . . to cumulate said shares and give one candidate as many votes

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1 PA. STAT. ANN. tit. 15, § 2852-403 (Purdon 1955).
2 PA. STAT. ANN. tit. 7, § 819-503 (Purdon 1955).
3 PA. CONST. art. 16, § 4 (1874); PA. STAT. ANN. tit. 15 § 2852-505 (Purdon 1938).
4 BALLANTINE, CORPORATIONS § 177 (Rev. Ed. 1946); STEVENS, CORPORATIONS 530 (2nd ed. 1949); 56 DICK L. REV. 330 (1951); 22 U. CHI. L. REV. 751 (1955).
5 126 N. E. 2d 701 (Ill. 1955), discussed in 9 MIAMI L. Q. 365 (1955).
6 ILL. CONST. art. 11, § 3 (1870).

as the *number of directors* multiplied by the number of his shares . . . ." The court said that "number of directors" means the whole number of directors of the corporation, not the number to be elected at that particular meeting. Therefore the statutory authorization of classification of directors whereby less than all could be elected at one time, being inconsistent, was declared to be unconstitutional. The fact that it had been in effect for eighty-three years and that fifteen Illinois corporations, acting in reliance on it had provided for classification of directors, was tersely disposed of by saying, "Age, however, does not immunize a statute from constitutional attack".

Turning to the Pennsylvania constitutional provision for cumulative voting, we are again confronted with a problem of philology. It expressly provides that:

> "In all elections for directors . . . each . . . shareholder may cast the whole number of his votes for one candidate or distribute them upon two or more candidates as he may prefer."[7]

Does this contemplate elections in which all directors are elected at one time, or elections in which only a certain class of directors are elected? The case of *Hays v. Com.*,[8] decided two years after passage of the above constitutional provision, strongly suggests the former. In the *Hays* case, the court, in commenting on the constitutional cumulative voting provision, says:

> ". . . This section is understood to confer upon the individual stockholder the right to cast all votes which his stock represents, multiplied by the number of directors . . . *to be elected,* for a single candidate, should he think proper so to do . . . . [W]e have no doubt (that) we have in our statement embodied the intention of the convention." (Emphasis added.)

It is submitted that the number of directors "to be elected" means the whole board of directors, since classification was not authorized until 1887 (eleven years after this case).

Although a constitutional provision such as that requiring cumulative voting, is self-executing and does not require legislation to make it effective,[9] the legislature, in the Business Corporation Law of 1933[10] provided that:

> ". . . In all elections for directors, every shareholder entitled to vote shall have the right . . . to multiply the number of votes to which he may be entitled by the number of directors *to be elected,* and he may cast the whole number of such votes for one candidate or he may distribute them among any two or more candidates . . . ." (Emphasis added.)

Thus, the language of the *Hays* case is brought into the cumulative voting provision, after classification is allowed. Some interesting language was added to this provision by a 1953 amendment, which provided:[11]

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7 PA. CONST. art. 16 § 4 (1874).
8 82 Pa. 518 (1876).
9 Pierce v. Com., 104 Pa. 150 (1883).
10 PA. STAT. ANN. tit. 15, § 2852-505 (Purdon 1938).
11 PA. STAT. ANN. tit. 15, § 2852-505 (Purdon 1955).

> ". . . In all elections for directors, every shareholder entitled to vote shall have the right . . . to multiply the number of votes to which he may be entitled by the total number of directors to be elected *in the same election* . . . ."

Whether or not this correctly interprets the constitutional provision of 1874, has never been decided by our courts.

The second jurisdiction to recently resolve a conflict between cumulative voting and classification of directors in favor of the former, is Ohio. In *Humphrys v. Winous Co.*[12], the inconsistency was between two sections of the same statute. There was no constitutional provision involved. In this case, the board of directors attempted to change the election from three directors elected annually for a one year term, to three classes of directors, one in each class, to be elected for three year terms, one each year. This would, of course, completely nullify any advantage to minority stockholders derived from cumulative voting. Since the statute relating to cumulative voting provided that "Such right to vote cumulatively shall not be restricted or qualified by any provisions in the article or regulations . . . .",[13] the court decided that this language was specific while that relating to classification of directors was general and therefore the former modified the latter. The time element here, during which both sections stood together was a mere twenty-eight years. The court apparently did not deem this worthy of comment.

In any event, the *Wolfson* and *Humphrys* cases focus new light upon the controversy between cumulative voting and classification of directors. What Pennsylvania will do, if anything, is a matter of conjecture.

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12 125 N. E. 2d 204 (Ohio 1955).
13 OHIO REV. CODE ANN. § 1701.58 (Baldwin 1953).