

Corporations: Shareholder Ratification of Directors' Action

Donald J. Zadeck

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certainty that dividends shall not be paid except from surplus.⁴³ It cannot be denied that such statutory policy of dividend restriction is intended primarily for protection of creditors.

There is no need for future Louisiana litigation to shoot judicial rapids experienced in other states, replete with confusing and conflicting theories of shareholders' liability. Preventive legislation is desirable. An amendment to Subdivision II of Section 27 of the Louisiana Corporation Act, allowing the creditors, in addition to the corporation, a direct action against shareholders to recover illegal dividends, regardless of the good faith of the shareholder, solvency of the corporation, or position of the creditor's claim in relation to the declaration of the dividend, would insure the basic relationships of both creditors and shareholders and uphold the clear statutory policy of dividend restrictions.⁴⁴ A very brief prescriptive period for this action would relieve the shareholder of a long period of uncertainty, which has been the touchstone of so many decisions allowing the good faith stockholder to retain a clearly illegal dividend.⁴⁵

Subdivision III of Section 27 of the Louisiana Corporation Act provides that directors who are held liable "for the sole reason of having acted negligently" shall have a right of action over against each shareholder for the proportionate amount of the illegal dividend, distribution, payment or return of assets received by the shareholder. This excellent provision in our corporation law has been highly commended as an appropriate statutory method of reimbursing merely negligent directors who should not be made to stand this burden for such a minor misfeasance.⁴⁶

WILLIAM F. WILSON, JR.

CORPORATIONS: SHAREHOLDER RATIFICATION OF DIRECTORS' ACTION

It often happens that the board of directors of a corporation authorizes an unenforceable transaction. Such transactions are unenforceable because they are either ultra vires, voidable, or

43. La. Act 250 of 1928, § 26(I) [Dart's Stats. (1939) § 1106(I)].

44. Ballantine, *Corporations* (1946) 601, § 255. "The true basis of liability (of the shareholder) is neither the trust fund theory nor a fraudulent conveyance theory, but the enforcement of the statutory policy of dividend restrictions and the questions of what remedies are practical and just for the purpose of protecting all parties concerned."

45. See note 30, *supra*.

46. Briggs, *Stockholders' Liability for Unlawful Dividends* (1934) 8 Temple L. Q. 145, 184.

illegal. The scope of this article is to determine which of these transactions may be subsequently ratified¹ by the shareholders at a duly constituted meeting and what proportionate vote is necessary to accomplish the ratification.

Ultra Vires Transactions

With regard to ultra vires transactions the authorities are in a state of hopeless confusion. "The situation is such that the law in any given state can be determined, if at all, only by a minute examination of the local decisions."² Much of the conflict is attributable to the loose definitions of ultra vires transactions.³ Some courts consider an ultra vires act to be one which the corporation has no *power* to perform;⁴ others look upon it as an act which is legal in its inception, but beyond the *authority* of the corporation to perform.⁵

The courts committed to the lack of power doctrine consider an ultra vires transaction invalid hence incapable of ratification⁶ even by the unanimous assent of the shareholders.⁷ Notwithstanding the inability of the shareholders to ratify the transaction and

1. This comment will be limited as much as possible to formal ratification by the shareholders, and estoppel will be considered only incidentally.

2. 2 Machem, *Modern Law of Corporations* (1908) § 1021.

3. "Possibly there is no term in the whole law used as loosely and with so little regard to its strict meaning as the term 'ultra vires.' Unfortunately this expression has been used by the courts and by the writers on corporation law as meaning several things, and this has resulted in much confusion." 7 Fletcher, *Cyc. Corp.* (perm. ed. 1931) § 3399.

4. *Savannah Ice Co. v. Canal-Louisiana Bank & Trust Co.*, 12 Ga. App. 818, 79 S. E. 45 (1913). Cf. *Liverpool & L. & G. Ins. Co. v. Aleman Planting & Mfg. Co.*, 166 La. 457, 117 So. 554 (1928).

5. *Stevens v. Boyes Hot Springs Co.*, 113 Cal. App. 479, 298 Pac. 508 (1931).

6. *Pattison v. Illinois Bankers Life Ass'n*, 360 Ill. 616, 196 N. E. 882, affirming 278 Ill. App. 394 (1935) (writing of a policy of insurance beyond the statutory powers) where the court said, "Whether a corporation is estopped to set up the defense of ultra vires depends upon whether the acts are beyond the purposes or powers of the corporation. If the power to make such contract is entirely wanting there could be no power to ratify it, and such attempted contract could not be given vitality by the acts of the parties under it." In re *New State Life Ins. Co.*, 164 Okla. 208, 23 P.(2d) 376 (1933) (insurance company advanced large sums of its stockholders' money to another insurance company); *Tilden v. Barber*, 268 Fed. 587 (D. C. N. J. 1920) (dummy directors voting bonds and stocks to promoters for over-valued consideration); *Edward Hines Western Pine Co. v. First Nat. Bank of Chicago*, 61 F.(2d) 503 (C. C. A. 7th, 1932) (purchase of promissory notes wherein the corporation had no interest).

7. *Savannah Ice Co. v. Canal-Louisiana Bank & Trust Co.*, 12 Ga. App. 818, 826, 79 S. E. 45, 50 (1913), where the court said, "But we prefer to base our decision upon the broader ground that the consent of all the stockholders will not estop the corporation from challenging the legality of an act which is wholly beyond the scope of its charter powers." *Piedmont Feed & Grocery Co. v. Georgia Feed & Grocery Co.*, 52 Ga. App. 847, 184 S.E. 899 (1935); *Ashbury Ry. Carriage & Iron Co. v. Riche*, L.R. 7 H.L. (E. & I. App.) 653, 33 L.T.(N.S.) 450 (1875); *Thomas v. Railroad Co.*, 101 U.S. 71, 25 L.Ed. 950 (1879).

by so doing to render it valid, it has usually been held that the shareholders are estopped to challenge the want of power of the corporation after unanimously assenting,⁸ although there is substantial authority to the contrary.⁹ However, a single dissenting shareholder may urge the invalidity in a proper case.¹⁰

In jurisdiction in which an *ultra vires* transaction is considered to be one legal in its inception but beyond the authority of the corporation to perform,¹¹ the approach is different. Here the assent of the shareholders will bind the corporation, and the effect is the same as if the transaction had been duly authorized in the first instance.¹² The assent must be unanimous;¹³ hence, the transaction may be enjoined by a dissenting minority shareholder.¹⁴ It follows logically that since majority shareholders have no power to do an *ultra vires* act initially and by so doing bind a dissenting minority shareholder, they have no power to ratify

8. Perkins v. Trinity Realty Co., 69 N.J. Eq. 723, 732, 61 Atl. 167, 170 (1905), where the court pointed out, "To permit stockholders of a corporation to unanimously make a disposition of the corporate property where no one else's rights are in any way prejudiced, and afterwards to repudiate their action upon the ground that it was beyond the power of the fictional body to do the act, could serve no useful purpose, and would be merely available in aid of fraud." Gallup v. Pring, 108 Colo. 277, 116 P.(2d) 202 (1941); Lawson v. Woodmen of the World, 88 Utah 267, 53 P.(2d) 432 (1936).

9. See Savannah Ice Co. v. Canal-Louisiana Bank & Trust Co., 12 Ga. App. 818, 79 S.E. 45 (1913); Piedmont Feed & Grocery Co. v. Georgia Feed & Grocery Co., 52 Ga. App. 847, 184 S.E. 899 (1935); Thomas v. Railroad Co., 101 U.S. 71, 25 L.Ed. 950 (1879).

10. Von Arnim v. American Tube Works, 188 Mass. 515, 74 N.E. 680 (1905); Schwab v. E. G. Potter Co., 128 App. Div. 36, 113 N.Y. Supp. 439 (1908). See 13 Fletcher, Cyc. Corp. (perm. ed. 1931) § 5823.

11. La. Act 250 of 1923, § 12, I [Dart's Stats. (1939) § 1092, I], where it is said that a corporation "shall have the capacity to act possessed by natural persons, but such corporation shall have authority to perform only such acts as are necessary or proper to accomplish its purposes as expressed or implied in the articles or that may be incidental thereto, and which are not repugnant to law." See also 9 U.L.A. 92 (perm. ed. 1942).

12. Lake Park Development Co. v. Paul Steenberg Const. Co., 201 Minn. 396, 401, 276 N.W. 651, 654 (1937), where the court said, "Stockholders of a corporation may by their unanimous consent, either by direct act or acquiescence, invest officers of the corporation with general corporate powers involving *ultra vires* acts and appropriation of corporate assets to noncorporate purposes, where, as here, rights of creditors and violations of law are not involved, so that all acts done within the scope of such powers are the acts of the corporation, binding upon it and the stockholders." Collins v. Hite, 109 W. Va. 79, 153 S.E. 240 (1930).

13. See Schwab v. E. G. Potter Co., 194 N.Y. 409, 87 N.E. 670, affirming 129 App. Div. 36, 113 N.Y. Supp. 439 (1908).

14. Von Arnim v. American Tube Works, 188 Mass. 515, 74 N.E. 680 (1905); Schwab v. E. G. Potter Co., 129 App. Div. 36, 113 N.Y. Supp. 439 (1908); Stevens v. Rutland & Burlington Ry., 29 Vt. 545, 563 (1851), a case frequently cited with approval, wherein the court pointed out that "in case of private associations and corporations it is not the doctrine that a majority [of the stockholders] can bind the minority in a matter beyond and aside of their original articles of association, or charter of incorporation." See 13 Fletcher, Cyc. Corp. (perm. ed. 1931) § 5823.

such an act already done and bind him. Majority shareholders cannot do indirectly what they cannot do directly. Thus a minority shareholder may enjoin the directors and majority shareholders from engaging in a line of business which is unauthorized by the charter,¹⁵ or from ultra vires dealings in stock.¹⁶ Similarly a transaction involving a misappropriation of corporate assets or the giving away of corporate property¹⁷ may be set aside or enjoined. It is no defense to the minority shareholder's suit that the transaction may be beneficial to the corporation and one that cannot injure the shareholders.¹⁸

Voidable Transactions

Voidable transactions embrace a wide variety of situations where the directors' action is subject to shareholder rejection or ratification. The most common type of voidable transaction is that in which a director votes on a matter in which he has a personal interest. Such a transaction is voidable, whether it is fair or not,¹⁹ if the interested director's presence was necessary to constitute a quorum²⁰ or if his vote was necessary to pass the

15. *Cherokee Iron Co. v. Jones*, 52 Ga. 276 (1874), where the court enjoined the use of corporate funds to erect a corn and flour mill, the corporation being incorporated to manufacture pig iron.

16. *Dunbar v. American Telephone & Telegraph Co.*, 224 Ill. 9, 79 N.E. 423, 115 Am. St. Rep. 132, 8 Ann. Cas. 57 (1906).

17. *Rogers v. Hill*, 289 U.S. 582, 53 S.Ct. 731, 77 L.Ed. 1385, 88 A.L.R. 744 (1933); *Lake Park Development Co. v. Paul Steenberg Construction Co.*, 201 Minn. 396, 276 N.W. 651 (1937); *Jorndt v. Reuter Hub & Spoke Co.*, 112 Mo. App. 341, 87 S.W. 29 (1905); *Pollitz v. Wabash Ry.*, 207 N.Y. 113, 100 N.E. 721 (1912), affirming 150 App. Div. 715, 135 N.Y. Supp. 789 (1912); *Continental Securities Co. v. Belmont*, 206 N.Y. 7, 99 N.E. 138, 51 L.R.A. (N.S.) 112, Ann. Cas. 1914A 777 (1912), same case 83 Misc. 340, 144 N.Y. Supp. 801 (1914); *Stony Brook Lumber Co. v. Blackman*, 268 Pa. 305, 133 Atl. 556 (1926).

18. *Davis v. Congregation Beth Tephilas Israel*, 40 App. Div. 424, 57 N.Y. Supp. 1015 (1899); *Central Railroad v. Collins*, 40 Ga. 582, 617 (1869), wherein it was said, "We do not think the profitableness of this contract, to the stockholders . . . has anything to do with the matter. These stockholders have a right, at their pleasure, to stand on their contract. If the charters do not give these companies the right to go into this new enterprise, any one stockholder has a right to object." See also *Byrne v. Schuyler Electric Manufacturing Co.*, 65 Conn. 336, 31 Atl. 833, 28 L.R.A. 304 (1895).

19. *Burns v. National Mining, Tunnel & Land Co.*, 23 Colo. App. 545, 550, 130 Pac. 1037, 1039 (1913), wherein the court quoted 10 *Fletcher, Cyc. Corp.* (perm. ed. 1931) 790 with approval, as follows: "'A director cannot, with propriety, vote in the board of directors upon a matter affecting his own private interest any more than a judge can sit in his own case; and any resolution passed at a meeting of the directors at which a director having a personal interest in the matter voted will be voidable at the instance of the corporation or the shareholders, without regard to its fairness, provided the vote of such director was necessary to the result.'" *Carr v. Kimball*, 153 App. Div. 825, 139 N.Y. Supp. 253 (1912); *Russell v. Henry C. Patterson Co.*, 232 Pa. St. 113, 81 Atl. 136, 36 L.R.A. (N.S.) 199 (1911).

20. See *Curtin v. Salmon River Hydraulic Gold Mining & Ditch Co.*, 130 Cal. 345, 62 Pac. 552, 80 Am. St. Rep. 132 (1900); *Federal Life Ins. Co. v.*

resolution.²¹ The reason for the voidability of such a transaction is manifest. A director stands in a fiduciary relationship to the corporation²² and should not be permitted to act where his own self interest will conflict with the interests of the corporation. Thus, it has been held that a resolution fixing the salary²³ of a director, or a resolution to purchase land belonging to the directors,²⁴ is voidable if the vote of the interested director or directors was necessary to its passage.

Such possibly self-serving action of the directors may be ratified by a majority of the shareholders²⁵ voting in a duly constituted meeting, and in the absence of fraud or unfairness the interested directors may cast their votes as majority shareholders.²⁶ If, however, the actions of the directors constitute a fraud²⁷ on the corporation, the majority shareholders cannot bind the corporation against the vote of a dissenting shareholder.²⁸

Griffin, 173 Ill. App. 5 (1912); *Mobile Land Improvement Co. v. Gass*, 142 Ala. 520, 39 So. 229 (1904).

21. *Hodge v. United States Steel Corp.*, 64 N.J. Eq. 807, 54 Atl. 1, 60 L.R.A. 742 (1903); *Carr v. Kimball*, 153 App. Div. 825, 139 N.Y. Supp. 253 (1912). But see *Nordgren v. Oldham Rural Tel. Co.*, 40 S.D. 460, 168 N.W. 26 (1918).

22. *Bates Street Shirt Co. v. Waite*, 130 Me. 352, 156 Atl. 293 (1931); *Bennett v. Klipto Loose Leaf Co.*, 201 Iowa 236, 207 N.W. 228 (1926); *Jacobson v. Brooklyn Lbr. Co.*, 184 N.Y. 152, 76 N.E. 1075 (1906).

23. *Murray v. Smith*, 166 App. Div. 528, 152 N.Y. Supp. 102 (1915); *Booth v. Beattie*, 95 N.J. Eq. 776, 118 Atl. 257 (1924); *Russell v. Henry C. Patterson Co.*, 232 Pa. St. 113, 81 Atl. 136, 36 L.R.A.(N.S.) 199 (1911). But see *McKey v. Swenson*, 232 Mich. 505, 205 N.W. 583 (1925); *Briggs v. Gilbert Grocery Co.*, 116 Ohio St. 343, 156 N.E. 494 (1927).

24. *Klein v. Independent Brewing Ass'n*, 231 Ill. 594, 83 N.E. 434 (1907); *Bjorngaard v. Goodhue County Bank*, 49 Minn. 483, 52 N.W. 48 (1892).

25. *Pollitz v. Wabash R.R.*, 207 N.Y. 113, 100 N.E. 721, affirming 150 App. Div. 715, 135 N.Y. Supp. 789 (1912); *Continental Securities Co. v. Belmont*, 206 N.Y. 7, 99 N.E. 138, 51 L.R.A.(N.S.) 112, Ann. Cas. 1914A 777 (1912); *Russell v. Henry C. Patterson Co.*, 232 Pa. St. 113, 81 Atl. 136, 36 L.R.A.(N.S.) 199 (1911). But see *McKey v. Swenson*, 232 Mich. 505, 205 N.W. 583 (1925).

26. *Bjorngaard v. Goodhue County Bank*, 49 Minn. 483, 52 N.W. 48 (1892); *Hodge v. United States Steel Co.*, 64 N.J. Eq. 807, 54 Atl. 1, 60 L.R.A. 742 (1903); *Russell v. Henry C. Patterson Co.*, 232 Pa. St. 113, 121, 81 Atl. 136, 139, 36 L.R.A.(N.S.) 199, 204 (1911), wherein the court pointed out "that the resolution of the stockholders ratifying the action of the directors in increasing the salaries was not invalid because it was done by the votes of the same individuals by whose votes the resolution of the board of directors was passed and two of whom were the recipients of the salaries." But see *Smith v. Bunge*, 272 Ill. App. 182 (1933). See Comment (1929) 28 Mich. L. Rev. 181.

27. For an excellent discussion of Shareholder Ratification of Directors' Fraudulent Acts, see Comment (1940) 53 Harv. L. Rev. 1368.

28. *Dana v. Morgan*, 219 Fed. 313 (D.C. N.Y. 1914); *Eshleman v. Keenan*, 187 Atl. 25 (Del. Ch. 1936); *Klein v. Independent Brewing Ass'n*, 231 Ill. 594, 83 N.E. 434 (1907); *Brewer v. Boston Theatre*, 104 Mass. 378 (1870); *Continental Securities v. Belmont*, 206 N.Y. 7, 99 N.E. 138 (1912); *Godley v. Crandall & Godley Co.*, 212 N.Y. 121, 105 N.E. 818, L.R.A. 1915D 632 (1914).

Illegal Transactions

An illegal transaction is one that contravenes some positive law, statute or charter, or is against public policy.²⁹ "The courts sometimes fail to note the difference between ultra vires and illegal contracts, and apply the rules relating to the effect of ultra vires contracts to contracts either expressly prohibited or against public policy, without in any way noticing the distinction."³⁰ While it may be said that all illegal acts are ultra vires³¹ the converse is certainly not true.

It would appear to be axiomatic that an illegal transaction entered into by the board of directors cannot be ratified by a majority of the shareholders³² so as to prevent a minority shareholder from obtaining relief.³³ Indeed, there can be no ratification of an illegal transaction that will render it enforceable.³⁴

No Louisiana cases have been found which have application to the above situations. It seems likely that the Louisiana courts will treat an ultra vires transaction as one legal in its inception and beyond the *authority* of the corporation rather than one in which the corporation has no *power* to perform, in view of Section 12, I, of the Louisiana Business Corporation Act.³⁵ With regard to voidable and illegal transactions, presumably the Louisiana courts will follow the majority decisions of the various common law state courts, that is, that voidable transactions may be ratified by a majority of the shareholders and that illegal transactions cannot be ratified at all.

DONALD J. ZADECK

JURISDICTION OVER INTERSTATE HOMICIDES

As a general proposition it is true that the criminal law of a state has no extraterritorial operation.¹ In view of the compli-

29. *Staacke v. Routledge*, 111 Tex. 489, 241 S.W. 994 (1922).

30. 7 *Fletcher, Cyc. Corp.* (perm. ed. 1931) § 3582.

31. *Eckhart v. Heier*, 38 S.D. 524, 162 N.W. 150 (1917).

32. *Von Arnim v. American Tube Works*, 188 Mass. 515, 74 N.E. 680 (1905); *Commonwealth v. Richmond, Fredericksburg & Potomac R.R.*, 111 Va. 611, 69 S.E. 1070 (1911).

33. *Forrester v. B. & M. Consol. Copper & Silver Min. Co.*, 21 Mont. 544, 55 Pac. 229 (1898).

34. *Cartwright v. Albuquerque Hotel Co.*, 36 N.M. 189, 11 P.(2d) 261 (1932); *Runcie v. Corn Exchange Bank Trust Co.*, 6 N.Y.S.(2d) 616 (1938); *Baird v. McDaniel Printing Co.*, 25 Tenn. App. 144, 148, 153 S.W.(2d) 135, 138 (1941), in which the court pointed out that "Corporate transactions which are illegal because prohibited by statute are void, and cannot support an action nor become enforceable by performance, ratification, or estoppel."

35. La. Act 250 of 1928, § 12, I [Dart's Stats. (1939) § 1092, I].

1. See *Marshall v. Nebraska*, 6 Neb. 120, 29 Am. Rep. 363 (1877).

State v. Chapin, 17 Ark. 561 (1856); *Beattie v. State*, 73 Ark. 428, 84 S.W.