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# Litigation of Contested Corporate Elections

There are various ways in which an illegal or fraudulent election of directors of a corporation may be judicially investigated and remedied. Such remedies are quo warranto, mandamus, or a suit in equity. Each of these remedies, however, is beset with delays, expenses, and technical difficulties. For example, quo warranto and mandamus have been considered extraordinary remedies and are a subject for the sound discretion of the court.<sup>1</sup> A court may refuse these remedies even though the technical requirements for allowing them may be present.<sup>2</sup> Usually, courts will be loath to grant the extraordinary relief afforded by quo warranto, except when the ultra vires acts, as such, endanger the interests of the people, or where there has been a radical departure from the spirit of the charter.<sup>3</sup> If the relator is not an "interested" party,<sup>4</sup> and if there is another "adequate" remedy,<sup>5</sup> quo warranto will not be permitted. In some jurisdictions quo warranto proceedings may be brought only by the attorney general ex officio.<sup>6</sup> Limitations have also been put on the use of a suit in equity in contesting elections. Whereas a court of equity may prior to the holding of an election enjoin such an election,<sup>7</sup> a different rule prevails after the election has actually taken place. A court of equity has no inherent power or jurisdiction to entertain a bill for the purpose of reviewing a corporate election and ousting the parties who claim to have been elected unless the question arises incidentally in connection with some other equitable matter.<sup>8</sup> As a consequence, some jurisdictions have enacted statutes which are intended to afford more speedy relief to a stockholder who may be aggrieved by a cor-

<sup>1</sup> *People v. State Auditors*, 42 Mich. 422, 4 N.W. 274 (1880); *Attorney General v. Erie Ry.*, 55 Mich. 15, 20 N.W. 696 (1884); *Whitcomb v. Lockerby*, 57 Minn. 411; 59 N.W. 495 (1894); *People v. Gas Light Coke Co.*, 205 Ill. 482, 68 N.E. 950 (1903); *State v. Endowment Trust Co.*, 140 Ala. 610, 37 So. 442 (1904); *State v. Cupples Power Co.*, 283 Mo. 115, 223 S.W. 75 (1920).

<sup>2</sup> *People v. State Auditors*, 42 Mich. 422, 4 N.W. 274 (1880).

<sup>3</sup> *State v. Minn. Thresher Mfg. Co.*, 40 Minn. 225, 41 N.W. 1020 (1889).

<sup>4</sup> *State v. Point Roberts Co.*, 42 Wash. 409, 85 P. 22 (1906); *State v. Union Hebrew Congregation*, 309 Mo. 587, 274 S.W. 413 (1925).

<sup>5</sup> *People v. Mutual Gas Light Co.*, 38 Mich. 154 (1878); *People v. Consolidated Gas Co.*, 130 App.Div. 626, 115 N.Y.S. 393 (1st Dept. 1909); *Gardner Trust Co. v. Whitehead Corp.*, 260 Mass. 239, 157 N.E. 519 (1927).

<sup>6</sup> *Attorney General v. Adonai Shamo Corp.*, 167 Mass. 424, 45 N.E. 762 (1897); *Thirteenth Street Ry. v. Broad Street Rapid Transit Co.*, 210 Pa. 10, 67 A. 901 (1907); *Sherwood v. Mammoth Vein Coal Co.*, 195 Iowa 365, 185 N.W. 279 (1921).

<sup>7</sup> *Chiera v. Breevoort*, 97 Mich. 638, 57 N.W. 193 (1893).

<sup>8</sup> *People v. Albany R.R.*, 57 N.Y. 161, 171 (1874); *New England Mut. Life Ins. Co. v. Phillips*, 141 Mass. 535, 6 N.E. 534 (1886); *Perry v. Tuskalooza Cotton Seed Oil Co.*, 93 Ala. 364, 9 So. 217 (1891).

<sup>9</sup> 2 Cook, *Corporations* 1690 (6th ed. 1908).

porate election.<sup>9</sup> These statutes, unattended by the delays and difficulties usually attributed to an ordinary suit in equity, mandamus, or writ of quo warranto, empower a court, sitting as a court of chancery, to review an election, confirm the election, order a new one, or make such order as it deems best.<sup>10</sup> A proceeding under these statutes is intended to furnish a simple, just and effective remedy for all complaints, free from useless technicalities and unnecessary expense. In such proceedings the courts are interested in the merits rather than in technique and procedural niceties.<sup>11</sup>

The Virginia statute<sup>12</sup> is confined to controversies concerning "any election for directors, or any proceeding, act or matter touching the same," and within this limitation, "the judge shall proceed forthwith and in a summary way, to hear the allegations and proofs introduced by the parties, or otherwise inquire into the matter," and to "give such relief in the premises as right and justice may require." Contested elections are litigated by a summary proceeding. The trial judges are allowed wide discretion in the exercise of the power thus conferred. They may and ought to be governed by equitable principles and should deal with cases arising under the statute in accordance with substantive right and justice, but they are not saddled to any hard and fast legal or equitable rules.<sup>13</sup>

While the Virginia statute is clearly designed to eliminate difficulties attending quo warranto, mandamus, or an ordinary suit in equity, many problems arise which are not readily apparent. It is the purpose of this note to examine the problems that face dissident stockholders in contesting elections under this statute. In many instances it will be necessary because of the

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<sup>9</sup> Stratford v. Mallory, 70 N.J.L. 294, 58 A. 347 (1904).

<sup>10</sup> 2 Cook, *Corporations* 1691 (6th ed. 1908).

<sup>12</sup> Va. Code §13-205 (1950): "Any stockholder who may be aggrieved by, or complain of, any election for directors, or of any proceeding, act, or matter touching the same, may, after giving reasonable notice to the corporation and to any person who is to be affected thereby, otherwise than as a stockholder only, make application by petition to the judge of the circuit court of the county, or of the circuit, corporation, or chancery court of the city wherein the principal office in this State of such corporation is located, in term time or vacation, and the judge shall proceed forthwith and in a summary way, to hear the allegations and proofs introduced by the parties, or otherwise inquire into the matter, or cause of complaints, and thereupon establish the election so complained of, or order a new election, or make such order and give such relief in the premises as right and justice require. Pending the hearing and determination of an application to investigate an election of directors, the judge may, by order, restrain the persons claiming to have been elected directors from exercising any of the functions or duties of the office."

<sup>13</sup> Pierce Oil Corp. v. Voran, 136 Va. 416, 118 S.E. 247 (1923).

paucity of the Virginia cases to view these problems in the light of interpretations given in various decisions under similar statutes and the opinions of Virginia judges interviewed.<sup>14</sup>

No answer is to be found in the Virginia statute or in Virginia cases as to when a stockholder who delays in complaining of an election may be barred of a remedy. The "reasonable diligence" rule is rather uncertain and difficult to state. The clearest examples of this problem are found in cases where a shareholder wishes to attack the election after such a lapse of time that the question of whether the stockholder has presented some good excuse for delay in not doing so must be determined. This issue was met squarely in *Jones v. Bonanza*,<sup>15</sup> a Utah case. The plaintiff after two years of inaction brought suit against the defendants to enjoin them from acting as the officers and board of directors, from holding certain stockholders' meetings and from entering into negotiations for and from making a sale of the property of the corporation. The lower court granted the relief prayed for and further decreed that the plaintiff and his associates were still the owners of and entitled to the stock which had been sold by the directors. On appeal, the Utah Supreme Court reversed. A stockholder who had the means of knowledge respecting all the circumstances of the sale of the corporation which he now claims was illegal and failed to manifest any interest in the annual stockholders' meetings although they were advertised and publicly held as required by law cannot now complain. A stockholder who applies to a court for its interference to protect his rights against the consequences of alleged wrongful acts of the directors or the legality of an election must act with reasonable diligence. The court's reasoning and conclusions are sound. After such a time that the position of the parties is apt to be substantially changed and the shareholder has shown apathy or inertia in bringing an action, there seems no apparent reason why the courts should restore the contestor to his former rights. In the final analysis, it is the contestor who must ride out many a tumultuous election and be alert to act on his own behalf.

The Virginia judges contacted<sup>16</sup> agree that the doctrine of laches should govern. Each case is unique. Whether the con-

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<sup>14</sup> Two Virginia judges who sit in heavily populated cities were consulted.

<sup>15</sup> 32 Utah 440, 91 P. 273 (1907).

<sup>16</sup> See note 14 *supra*.

testing party knew he had a right, whether the rights of third parties had intervened, whether undue delay was due to illness or negligence, are all circumstances which should be carefully considered by the court.

Under a statute similar to the Virginia one, an election may be declared void by reason of the conspiracy, fraud, or trickery of some of the stockholders.<sup>17</sup> This problem was before the Virginia Court in *Pierce Oil Corp. v. Voran*.<sup>18</sup> The charter of the corporation provided that when four quarterly dividends of the preferred stock were in default the voting power in the election of directors should pass to the preferred stockholders. The preferred stockholders on default of preferred dividends asserted their right to elect the directors. The corporation alleged that the default in the preferred dividends was caused by fraud and conspiracy on part of some of the preferred stockholders and others to financially embarrass the corporation and force such default. Although it was not denied that four quarterly dividends were in fact unpaid, the appellants alleged that the corporation had ample surplus out of which the dividends could have been paid and that therefore there was no default within the meaning of the charter. On appeal, the Court held that whether the corporation had a surplus out of which the dividends could be paid was immaterial, as the directors in passing the dividends had acted in good faith. The Court, sensing the necessity for further justifying their holding, concluded with the statement that 'the general rules of evidence as to fraud and conspiracy are well understood. Direct proof is seldom obtainable and circumstantial evidence, when solely relied upon, must be clear and convincing. This case points up the acute difficulty of upseating the elected directors on the ground of fraud or conspiracy. The introduction of proof of fraud and conspiracy is necessarily to a large extent a matter to be regulated by the sound discretion of the judge, and finding nothing to indicate an abuse of that discretion, the Supreme Court of Appeals refused to reverse the lower court's decision. Not only must a shareholder prove bad faith, but the evidence must be so clear and convincing as to entitle him to relief. However, there is ample justification for

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<sup>17</sup> *People v. Albany Ry.*, 55 Barb. 344, *affirmed*, 57 N.Y. 161 (1869).

<sup>18</sup> 136 Va. 416, 118 S.E. 247 (1923).

exactng such evidence as the rule effectively safeguards corporate elections from the danger of sham claimants.

Another difficulty that is posed is whether a stockholder may object to the legality of an election when he attends the election, votes and does not object to those voting or exhibits misconduct or neglect in regard to the election. This question has been passed upon in several jurisdictions.<sup>19</sup> It was held in the *Chenango* case<sup>20</sup> that an illegal vote not challenged will not invalidate an election, nor will an inquiry into it even be made. Again in *People v. Robinson*<sup>21</sup> it was said that a stockholder who attends the election and votes and does not object to others voting, although he knows that in doing so they are violating a by-law, cannot himself afterwards object to the legality of the election:

This question was peripherally before the Virginia Court in *Kemp v. Levinger*.<sup>22</sup> The charter provided that so long as the prior preference stock outstanding should be in excess of \$10,000,000 par amount, the holders of the prior preference stock should have the right, voting separately as a class, to elect a majority by one of the directors. Prior to the date of the election, the corporation had purchased and held in its treasury prior preference stock, which reduced the amount of prior preference stock in the hands of others to less than \$10,000,000. The chairman of the meeting declared that there was present in person or proxy a quorum of prior preference stockholders, but not a quorum of preferred and common stockholders. He stated that the holders of the prior preference stock had the right to proceed with the election of a majority by one of the directors and that for lack of a quorum of all the stockholders no other business could be transacted. The prior preference stockholders thereupon proceeded to elect a majority by one of the number of directors authorized. The contestor sought to enjoin the directors from functioning. The Supreme Court of Appeals in reversing the lower court's granting of an injunction said by way of dictum:

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<sup>19</sup> *In re Chenango County Mut. Ins. Co.*, 19 Wend. 635 (N.Y.Sup. 1839); *State v. Lehre*, 7 Rich.Law 234 (S.C. 1854); *People v. Robinson*, 64 Cal. 373, 1 P. 156 (1883).

<sup>20</sup> *In re Chenango County Mut. Ins. Co.*, 19 Wend. 635 (N.Y.Sup. 1839).

<sup>21</sup> 64 Cal. 373, 1 P. 156 (1883).

<sup>22</sup> 162 Va. 685, 174 S.E. 820 (1934).

It is interesting to note that appellee was present when both resolutions were adopted and voted on them, and was a member of a committee to arrange details and formulate plans for issuing the invitation to stockholders to tender their stock for sale to the corporation.

In other words, appellee, as a director and a member of this committee, in effect said to the prior preference stockholders, if you will sell to the corporation forty per cent of your stock, the remaining sixty per cent will still elect a majority of the directors, and hence will control the management of the corporation. He admits this, but claims that a resolution of the directors would not and could not change a charter provision. This is quite true. It was just as true before the adoption of the resolutions as it was afterwards. The action of the appellee in favoring the resolutions and subsequent action in contesting their validity leaves his good faith open to serious question.<sup>23</sup>

It is clear from the above cases that the legality of an election will not be inquired into upon the ground that illegal votes were cast unless those votes were challenged at the election. In general, a relator seeking to set aside a corporate election is barred from relief if he himself was guilty of misconduct or neglect, or if it appears that he has subsequently acquiesced with knowledge of the facts. What has been overlooked here, however, is that the courts should be empowered to consider the plaintiff's good faith with respect to his failure to make timely objection. The degree of his responsibility may be so negligible that his conduct may have been justified. It would seem that under these circumstances greater leniency could be allowed.

The question arises as to who has the burden of proof in attacking the validity of a vote. In the *Indian Zeodone* case<sup>24</sup> it was determined that in attacking the validity of a vote the burden of proof is on him who attacks. What is involved here is basically the right of a stockholder to express himself and have a bona fide right determined. Unfortunately, not all claims of stockholders are meritorious. Sometimes a stockholder is motivated by personal animosity toward a director, by a desire to promote his own end to the detriment of the corporation, or by

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<sup>23</sup> 162 Va. 685, 702, 174 S.E. 820, 827 (1934).

<sup>24</sup> *In re Indian Zeodone Co.*, L.R. 26 Ch.D. 70 (1884).

a misguided or over-zealous advocacy of quixotic schemes. By placing the burden of proof as to validity of the vote on the contestor, a number of would be "strike suitors" who would frequently intrude in election suits would be deterred from participating in them. There is no Virginia case in point; but the Virginia judges consulted<sup>25</sup> are in agreement with this rule. In their opinion the burden of overcoming the presumption of the validity of the vote should be on the contestor, and the party attacking cannot complain if he is unable to prove the illegality of the vote.

Significant difficulty has been encountered by stockholders in other jurisdictions as to who is entitled to contest an election. The general rule is that as between the corporation and the person offering to vote, the right follows the legal title to the stock of which the certificates and stock books are prima facie evidence.<sup>26</sup> But may a person claiming stock which stands in the name of another contest the validity of an election? It has been held that even though a person claims stock which stands in the name of another and might obtain such stock by a suit for that purpose, yet the court will not consider this in a statutory proceeding to contest the validity of an election, because only the stockholders of record are entitled to vote.<sup>27</sup> A reasonable interpretation of the Virginia statute is that it would entitle stockholders whose rights have been infringed to complain and to institute proceedings. Our Code Section<sup>28</sup> provides that any stockholder who may be aggrieved by an election for directors, may, after giving reasonable notice to the corporation and any other person who is to be affected, make application by petition to the court. This Section, taken in conjunction with Code Section 13-193,<sup>29</sup> which allows a corporation to provide for a different method of voting other than that based on record ownership, indicates that the drafters of the Sections did not intend that only shareholders of record would be entitled to contest an election.

A final hurdle that may confront a shareholder is the policy openly expressed in *Duffy v. Loft, Inc.*<sup>30</sup> and *Attebury v. Con-*

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<sup>25</sup> See note 14 *supra*.

<sup>26</sup> Commonwealth v. Dalzell, 152 Pa.St., 217, 25 A. 535 (1893).

<sup>27</sup> *In re Utica Fire Alarm Telegraph Co.*, 115 App.Div. 821, 101 N.Y.S. 109 (1906).

<sup>28</sup> Va. Code §13-205 (1950).

<sup>29</sup> Va. Code §13-193 (1950).

<sup>30</sup> 17 Del.Ch. 140, 151 A. 223, *affirmed*, 17 Del.Ch. 376, 152 A. 849 (1930).

*solidated Coppermines Corp.*,<sup>31</sup> two landmark cases favoring the finality of elections. In the words of the court in the *Duffy* case:

Where an extensive campaign has been carried on by rival groups for the votes of stockholders . . . the parties . . . should let the majority prevail. If . . . after the contest has been waged one side defeats a decision by mere tactical maneuvers, the whole business must be gone through again with its consequences of expense and disturbances.<sup>32</sup>

The policy adopted in these cases seems justifiable. There seems to be no reason for a court to set aside an election where every share of stock has been represented at the election. The courts have followed the policy that an election will not be invalidated if it can be shown that after throwing out the invalid votes the directors declared elected would still have, according to the return, a valid majority of the votes cast.<sup>33</sup> If Virginia were to follow this trend, the broad provisions of the Statute would not necessarily be defeated. The reasoning here is that even if a new election were ordered the result would be the same; therefore, the election should not be disturbed. Even though a shareholder feels he has a worthy complaint, the court will not consider the legality or illegality of votes when those votes will not change the result. Of course, this rule has not been applied to an election which is wholly illegal and without authority by reason of the organization of the corporation not being complete. In this type of case the complaining stockholders need not show that the results would be different in another election, and in declaring the election illegal the court will not permit the directors so elected to continue in office.<sup>34</sup>

The Virginia statute,<sup>35</sup> liberal in its provisions offers the most effective means of contesting elections so as to prevent delay and expense. It provides a clear statutory relief for stockholders to litigate their grievances. It seems pertinent here to comment upon the fact that the authors of the *Proposed Revision*

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<sup>31</sup> 26 Del.Ch. 1, 20 A.2d 743 (1941).

<sup>32</sup> 17 Del.Ch. 140, . . ., 151 A. 223, 228.

<sup>33</sup> *In re* Chenango County Mut. Ins. Co., 19 Wend. 635 (N.Y.Sup. 1839); *State v. Lehre*, 7 Rich.Law 234 (S.C. 1854).

<sup>34</sup> *In re* Empire State Supreme Lodge, 118 App.Div. 616, 103 N.Y.S. 465 (1907).

<sup>35</sup> Va. Code §13-205 (1950).

of the *Laws Relating to Corporations*<sup>36</sup> have failed to include a comparable or substituted section in their draft. They are now debating the omission of Virginia Code Section 13-205 altogether.<sup>37</sup> A stockholder wishing to contest an election under the proposed corporation law would be required to revert to the old remedies. This would be a significant step backwards. The old reliefs are encumbered with procedural difficulties, techniques and expense. For example, although a court may enjoin an election, the title of de facto officers to their offices cannot be tested by a bill in equity, but an additional proceeding by quo warranto lies. A dissident stockholder would thus be burdened with double expense of money and time.

Under the present Virginia statute<sup>38</sup> all grievances may be litigated in one action. The court may enjoin an election, review an election, oust the parties claiming to have been elected, or make such order as it thinks necessary. It is a summary proceeding intended to be simple and inexpensive. The court may exercise wide powers under this statute, and the strict rules as to the reception of evidence do not apply. Judges may focus their attention on the merits of the case rather than on the procedural fastidiousness required by the old remedies. Because of this wide discretion afforded the court and due to the clarity and unambiguity of the statute, the judges interviewed<sup>39</sup> recommend that no amendments be made to the present Code Section.

In summation, the decided cases indicate certain precautions that should be taken by those who are contesting an election in spite of the broad provisions offered by the statute. Possible mistrust in the good faith of the complainants in delaying to press their actions poses a plausible reason why courts refuse relief. Strong suspicion understandably arises in the minds of judges when such inertia exists. Fraud as a ground for invalidating an election must be specifically alleged and convincingly proved; and generally an election will not be set aside unless the evidence is clear and convincing. The problems of burden of

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<sup>36</sup> Code Commission of Virginia, *Proposed Revision of the Laws Relating to Corporations* (1955). This draft is under consideration by the Code Commission but has not as yet been approved by it.

<sup>37</sup> Correspondence with Special Counsel, Code Commission of Virginia, May 2, 1955.

<sup>38</sup> Va. Code §13-205 (1950).

<sup>39</sup> See note 14 *supra*.

proof and the possibility of a claim being denied because of misconduct, neglect, or acquiescence in regard to an election, while not unnecessarily restrictive, certainly present difficulties that the contestor must overcome.

The problems facing stockholders in contesting an election in no way detract from the efficiency of the statutory procedure. While a few may be injured, the tendency of the statute is to sift the bona fide from the sham suitors. The Virginia Code Section by its provisions truly confirms, and evidence places beyond cavil, the words of an eminent authority on corporation law with respect to similar statutes:

These statutes have proven to be among the wisest and best that legislatures have ever enacted in regard to corporations.<sup>40</sup>

Ann Elizabeth Calevas

*[Editor's Note: As a result of reading Miss Calevas' study in proof-form the Special Counsel for the Code Commission of Virginia reconsidered the omission of Code Section 13-205 from their PROPOSED REVISION OF THE LAWS RELATING TO CORPORATIONS. They have recommended to the Commission that it be retained "without any change of substance," but with "some modernization and simplification of the language."]*

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<sup>40</sup> 2 Cook, *Corporations* 1691 (6th ed. 1908).