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Corporations--Conflict Between By-Laws, Charters or Statutes and Long Term Employment Contracts

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Corporations—Conflicts Between By-Laws, Charters or Statutes and Long Term Employment Contracts—The plaintiff was employed as general manager of the defendant corporation under a three-year contract. Several months after beginning work, he was removed and his action for damages followed. The corporation contended that it had a right to remove the officer under a corporate by-law which stated that the manager “shall hold office at the pleasure of and upon the terms and conditions fixed by the Board of Directors.”

Held: An officer hired under a long term contract cannot be removed by the Board of Directors without cause, even under a corporation by-law that permits removal of the employee or agent at the pleasure of the board. United Producers and Consumers Cooperative v. Held, 225 F. 2d 615 (1955).

By its decision the court held that a corporate by-law is not effective to control the terms of a long term employment contract entered into by the corporation. However, the fact that the officer actually was removed suggests the necessity for making a distinction between the corporation’s “power” to remove and its “right” to do so. As one authority has stated it:

In spite of such a contract the corporation, like any other principal, has power to revoke the authority of its officers or agents at any time, subject to liability for this breach of contract. . . . (Emphasis supplied)

Kentucky has given the corporation the “power” to remove but does not allow the corporation to escape liability for breach of the contract “right” by providing in its General Corporation Act:

Any officer or agent may be removed by the board of directors whenever in their judgment the best interests of the corporation will be served thereby. Such removal, however, shall be without prejudice to the contract rights of the person so removed.

So an officer or employee cannot specifically enforce his continued employment by the corporation, but he can obtain damages for breach of the contract when the corporation exercises its power to remove him.

1 United Producers and Consumers Co-operative v. Held, 225 F. 2d 615, 617 (CA 9 1955).
2 The rule does not apply to “servants”. Munn v. Wellsburg, 66 W. Va. 204, 66 S.E. 230 (1909) (bookkeeper).
3 Stevens, Corporations, 766 (2d ed. 1949).
5 The Uniform Business Corporation Act, sec. 32 provides for this and states:

Any officer or agent may be removed by the Board of Directors whenever in their judgment the best interests of the corporation will be served thereby, but that such removal shall be without prejudice to the contract rights of the person so removed.
In stating their reasons for such a decision, the court in the Held case, quoting from a New York decision which arose in the federal courts, said:*

The consequences of accepting the opposite view are startling. It would mean that no New York stock corporation could make a binding contract of employment for a definite term; all officers, agents and employees would be dischargeable at will without liability on the part of the corporation, and it would follow that any of them could leave at will without incurring liability on their part, no matter how essential their services might be to the corporation. The announcement of such a doctrine would certainly cause surprise and consternation to the business world. . . .

A second possible reason for the result reached may have been the notice factor. It may result in an unreasonable burden to place a duty on parties dealing with corporations, either as potential officers, agents or otherwise, to have notice of the contents of all the corporate by-laws affecting the corporation's ability to contract.7

The majority of decisions are in agreement with the Held case in so far as the problem is one involving a conflict between a long term employment contract and a corporate by-law.8 But this is to be distinguished from two other instances where more confusion exists. These arise when the long term contract conflicts with either (1) the charter or articles of incorporation or (2) a statute.

A recent Kentucky decision involved the former in which a conflict existed between the provisions of a long term employment contract and the articles of incorporation.9 In that case the contract provided that the officer was to be employed by the corporation for ten years. In addition to his salary of $3,000 a month he was to receive an annuity on retirement in monthly payments of $150 multiplied by the number of full years he was employed. The officer could terminate the contract on three months notice; the employer could terminate it

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6 Supra note 1 at 618. The case cited was, in re Paramount Publix Corporation, 90 F. 2d 441 (CCA 2 1937) which construed sec. 60 of the N.Y. Stock Corporation Law.
7 See Stevens, Corporations, 726 (2d ed. 1949). It is very generally held that one dealing with corporation agents is not charged with notice of the by-laws.
8 Ballantine, Corporations, sec. 107 (Rev. ed. 1946):
   By the great weight of authority, however, if a corporation clothes an officer or agent with apparent authority to bind it by a particular contract or act, it cannot escape liability by setting up limitations or restrictions upon his authority contained in the by-laws not known to the third party. They are regarded as mere internal regulations, binding as between the corporation, its officers and shareholders.

See also, Realty Acceptance Corp. v. Montgomery, 51 F. 2d 636 (CCA 3 1930); Cuppy v. Stollwerck Bros., 216 N.Y. 591, 111 N.E. 249 (1916); Hill v. America Co-operative Ass'n, 195 La. 590, 197 So. 241 (1940).
on six months notice. A provision in the articles of incorporation prohibited the corporation from creating or incurring any indebtedness that would mature more than one year after the date of creation. On the basis of this provision the corporation contended that both the salary and annuity provisions should be invalid because they resulted in debts maturing beyond a year. The court took the position that a provision in an employment contract contrary to restrictions contained in the charter or articles of incorporation is invalid. Therefore, as to the case before them the court upheld the salary provision because it could be terminated on six months notice, but held the annuity debt invalid since once incurred it was not terminable, and as a result would conflict with the charter prohibition. Moreover the debt on the annuity arose after the employee had worked a year so the court thought it clearly contrary to the charter, resulting in the failure of the contract provision.

It seems that to hold an employment contract subject to the provisions of the charter may place an unjustifiable burden on the contracting employee particularly in view of the decisions allowing the employment contracts to prevail over the by-law. Moreover, the effect of the Kentucky court's decision is to hold the employee to constructive notice of the articles. These are not recorded to provide constructive notice of the contents to all who deal with the corporation as the decision would require, but only to provide certain essential information as to the business. Although many courts seem to feel that the recorded charter does give constructive notice the Uniform Business Corporation Act probably reflects the better policy by providing.

The filing or recording of the articles of incorporation, or amendments thereto, or of any other papers pursuant to the provisions of this Act is required for the purpose of affording all persons the opportunity of acquiring knowledge of the contents thereof, but no person dealing with the corporation shall be charged with constructive notice of the contents of any such articles or papers by reason of such filing of recording.

Possibly a more important objection to this case is that it allows the corporation to escape its contract obligation. As one authority explains it.

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10 See Stevens, Corporations, 727 (2d, 1949) where the courts are criticized for holding that the articles give constructive notice, but states: "It has been generally held that, since articles of incorporation are recorded in a public office, persons dealing with a corporation are charged with notice of the contents of the articles.
11 Uniform Business Corporation Act, (Model) §10 (1928).
12 II Fletcher, Corporations, 440 (Rev. ed. 1954).
[A] defense interposed by a corporation that its agent had no authority to execute a contract on its behalf is looked upon with disfavor, especially where the contract has been executed in whole or in part. It is the policy of the law and the endeavor of the courts to hold corporations as well as natural persons to their contracts.

But on the basis of its recent decision it would seem likely that the Kentucky court will hold a long term employment contract invalid when it conflicts with the provisions in the articles of incorporation.

The third instance is where the long term employment contract conflicts with a statutory provision. Generally, statutes permitting the board of directors to remove "officers, agents, or employees" at the board's pleasure, or will, have been construed as rendering fixed term employment contracts unenforceable and in some cases void. This is well illustrated by a decision under the National Banking Act where a long term contract conflicted with the statute. The statute provides that directors have power to dismiss officers "at pleasure". The court ruled that under the statute a long term contract was invalid, and thus the corporation does not incur any liability for dismissing the officer. Decisions, such as this are more understandable than those involving provisions in the articles of incorporation since an expression by the legislature should prevail over provisions or agreements to the contrary entered into by private parties. But after deciding that the statute prevails over the contract a second problem presents itself, namely, to whom does it apply? Although the National Banking Act applies only to bank officers, these statutes very often are more general in application and will apply to "officers, agents and servants" or to "officers, agents, or employees". When that is the case the interpretation of these terms should be determined in view of the policy underlying the statutes' enactment. The chief purpose of statutory provisions of this kind has generally been regarded as prevention of the board of directors of a corporation from handicapping or directing its policy after retirement from office. Therefore, it should apply to those "officers, agents and employees" who affect policy and occupy positions of responsibility and trust, e.g. a general

13 Munn v. Wellsburg Bkg. and T. Co., 66 W.Va. 204, 66 S.E. 230 (1909), merely recognizing the rule that where a statute is applicable a corporation is not liable on such an employment contract; Llewellyn v. Aberdeen Brewing Co., 65 Wash. 319, 118 P. 30 (1911); Van Slyke v. Andrews, 146 Minn. 316, 18, 178 N.W. 959, 12 ALR 1068 (1920); O'Donnell v. Sipprell, 163 Wash. 369, 1 P. 2d 322, 76 ALR 1405 (1931); 18 Am. Jur. 894.

14 12 USCA sect. 24 (1940).


17 In re Paramount Publix Corp., 90 F. 2d 441 (CA 2 1937).

18 Llewellyn v. Aberdeen Brewing Co., 65 Wash. 319, 118 P. 30 (1911).

19 111 ALR 894, 896 (1937).

20 Supra note 17.
manager of a corporation, a person employed to sell bonds and appoint local agents for an annuity company, or a managing head of a corporation's theater department. In contrast it should not apply to non-policy making positions, e.g. a carpenter, or a bookkeeper.

However, even in the third type situation there is substantial authority in favor of imposing liability on the corporation. A good example of this latter view is the interpretation put on the New York Stock Corporation law which allows the directors to remove an “officer, agent, or employee” at pleasure. This has been interpreted not to allow removal of an employee under a long term contract. The trend of recent authority seems to be in favor of imposing liability on the corporation.

CONCLUSION

Quite often a long term employment contract entered into between a corporation and one of its “officers, agents, or employees” may conflict with either a by-law, corporate charter, or statute which allows dismissal of the officer at pleasure. Although there is some disagreement in the cases the preferable solution would appear to be to hold the contract valid and enforceable when in conflict with a corporate by-law or the charter. The contracting outsider has no reason to have knowledge of the limitations to contract imposed on the corporation by either of these. But statutory restrictions on a corporation’s ability to contract presents a more difficult problem. Here it seems preferable to allow the statute to control the terms of the contract because of the paramount importance of an expression by the legislature as compared to an agreement between private parties. However, the full import of this should be confined somewhat by allowing the statute to apply only to policy making office-holders rather than mere servants or minor employees because the underlying policy behind such statutes is to prevent the board of directors from affecting corporate policy beyond their term of office.

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21 Long v. United Sec. and Annuity Co., 76 W. Va. 31, 84 S.E. 1053 (1915).
22 Supra note 16.
26 New York Stock Corporation Law, sec. 60 (1951).
27 In re Paramount Publix Corp., 90 F. 2d 441 (CCA 2 1937).