INFORMAL BY-LAW AMENDMENT BY INCONSISTENT
EMPLOYMENT CONTRACTS

It was the old belief that the tenure of a corporate officer should not extend too far beyond the term of the current board of directors, for it was feared that the holdover officers might hamper subsequent directors in the execution of their policy making function. This belief is yielding to the view that a better policy is served by allowing corporations to attract able executives with long term employment contracts. This transition in policy has been made in many states with the assistance of a statutory amendment authorizing long term employment contracts for corporate officers, but permitting the corporation to retain the one year limitation on tenure by an appropriate provision in the charter or by-laws. Such a statutory provision has found its way into the Model Business Corporation Act § 4(k) which, as Texas Business Corporation Act art. 2.02, was involved in Dixie Glass Co. v. Pollak.

The Dixie Glass Company, a closely held Texas corporation, had availed itself of its statutory power to limit the terms of its officers to one year by by-law provision. Nevertheless, all of the company's officers, directors, and shareholders in joint annual meeting had awarded one of their officers, the plaintiff in this action, a five year employment contract. The Texas Supreme Court had recently decided that a

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1 See generally O'NEAL, CLOSE CORPORATIONS ch. vi (1958).
3 An example is the 1951 amendment to article 1327 of the Texas statutes, TEX. REV. CIV. STAT. art. 1327 (Supp. 1952).
4 TEX. BUS. CORP. ACT ANN. art. 2.02A (1956). "Each corporation shall have power: . . . (12) to elect or appoint officers and agents of the corporation for such period of time as the corporation may determine, and define their duties and fix their compensation." The words "for such period of time as the corporation may determine" do not appear in the Model Act, but it is believed that these words add nothing save emphasis.
6 Dixie Glass Co. v. Pollak, supra note 5, at 534.
7 The office in question was that of comptroller, one not generally considered to be encompassed within the statutory designation "corporate office." It seems significant that the court could have upheld the validity of the employment contract by finding, as the plaintiff urged in the alternative, that the comptroller was not one of the officers whose tenure is limited to one year by the by-laws. Rather, the court assumed that the comptroller was an officer within the prohibition of the by-laws and that the by-law had been informally amended.
8 The contract further gave the plaintiff an option to renew for three additional
by-law limiting the tenure of a given corporate office to one year "by
necessary implication" limited contracts of employment in that office to
one year. Therefore, if the plaintiff in the Dixie case was to hold the
company liable for damages in breach of contract, he first had to estab-
lish the validity of a contract that was clearly inconsistent with the
by-laws.

The by-laws of the defendant corporation further provided for their
alteration or repeal by a majority vote of the directors or stockholders.
The court upheld the validity of the plaintiff's contract, stating that,"If the stockholders and directors can change or amend a by-law, they
may waive its application in a given case." In the peculiar facts of this
case, both the directors and stockholders unanimously approved the
five-year periods, a weekly salary of $200, and an annual bonus of 10% of net profits.

Dixie Glass Co. v. Pollak, 341 S.W.2d 530, 532 (1960).

See Pioneer Specialties Inc. v. Nelson, 339 S.W.2d 199 (Tex. 1960), in which the
Texas Supreme Court overruled this same appellate court which had upheld a two year
employment contract for the corporate president inconsistent with a by-law requiring
annual election of officers. The appellate court's theory had been that the language
of the statute indicated a distinction between "election" and "employment."

The dissent in this case, Pioneer Specialties v. Nelson, supra note 9, at 201,
suggested a resolution of the dilemma described in the first paragraph of this casenote,
how to attract able executives by long term employment security without entrenching
a possible bad choice in a position of control. The dissenting judges suggested that
the man selected to fill a statutory office be elected for one year or at the will of the
directors and that he then be given a long term employment contract to perform per-
functory clerical duties at a salary and other benefits commensurate with the elected
office. Thereafter the man could be removed from his statutory office with little or no
breach of contract liability if the best interests of the company so demanded and yet
the officer would be assured of a stipulated salary. The defect of this plan from the
company's point of view is the necessity of paying two salaries for one office if the first
officer under such contract were replaced. The weakness from the potential officer's
point of view is that to retain an influential office is part of the consideration to a man
rising in the management field. Demotion may not only affect his luster as a coming
executive, but also his financial return if, as part of his salary, he receives stock options
or a percentage of profits which he hopes to make more valuable by his efforts in the
office.

Upon trial the jury had found that the plaintiff had been dismissed without good

The possible argument that mere election to office, even without a contract makes
the company liable to the officer for expected benefits is thwarted by TEX. BUS. CORP.
ARTS 2.43A (1956), which provides that "election or appointment of an officer or
agent shall not of itself create contract rights."

The by-laws of the Dixie Glass Company at Section xviii as set out in the Dixie
opinion, supra note 11, at 535, "All by-laws of the company shall be subject to altera-
tion or repeal, and new by-laws may be made, either by the affirmative vote of the
holders of record of a majority of the outstanding stock of the company . . . or by the
affirmative vote of a majority of the whole Board of Directors . . . ."

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plaintiff's contract. However, the rationale and the tenor or the opinion would seem to sanction such informal amendment of the by-laws even if only the directors had approved the inconsistent contract and had done so by less than unanimous assent.'

Although the opinion in the Dixie Glass case is based on ample authority and seems fair and just on its facts, the limitations of the theory of informal amendment should be dearly defined lest the doctrine be extended to the point of rendering ineffectual restrictive by-law provisions. When a board of directors with power to amend the by-laws by formal action approves a contract inconsistent with the by-laws by the majority vote necessary for formal by-law amendment, two distinct but seldom distinguished theories can be utilized to uphold the contract. The first is amendment by implication, which is found only when the practice of disregarding the by-law has developed into a custom of sufficient long standing to give rise to the presumption that those with power to repeal the by-laws knew of and acquiesced in the violations.'

When the court finds an amendment by implication, the by-law ceases to have effect and can be disregarded from the time of its informal amendment forward. But far more frequently such a custom is not

In Dixie Glass Co. v. Pollak, supra note 14, at 536, the court approves the decision and rationale of Realty Acceptance Corp. v. Montgomery, 51 F.2d 636 (3d Cir. 1930), and paraphrases the argument of the plaintiff in that case, "...there was no statutory prohibition against employment of officers for a fixed term and that since a majority of the directors could amend the by-laws, their act in authorizing the contract was a pro tanto supersession of them and would prevail over them." The court then quotes from the opinion in Realty Acceptance Corp. v. Montgomery, supra at 639, "To read into a contract of employment for a definite period, expressly authorized by the board of directors, a by-law amendable by a majority of the board, and thus nullify the contract, would sacrifice substance and straightforwardness for form and procedure."

Havana Cent. Ry. v. Central Trust Co., 204 Fed. 546 (3d Cir. 1913)
In re Ivey & Ellington, 29 Del. Ch. 298, 42 A.2d 508 (1945) (amendment by implication not found for other reasons);
Bank of Holly Springs v. Pinson, 58 Miss. 421 (1880);
Farmer's State Bank v. Haun, 30 Wyo. 322, 222 P. 45 (1924). In the last case, a by-law requiring two signatures on all company checks was held ineffective upon the showing of a long-standing custom, known to the persons with power to change the by-laws, of paying company checks over a single signature.

Star Loan Ass'n v. Moore, 4 Penn. 308, 55 Atl. 946 (Super. Ct. of Del. 1903);
Bay City Lumber Co. v. Anderson, 8 Wash. 2d 191, 111 P.2d 771 (1941);
Huxtable v. Berg, 98 Wash. 616, 168 P ac. 187 (1917);

Some courts mention the interesting analogy to implied repeal of a statute, Flaherty v. Portland Longshoreman's Benev. Soc'y, 99 Me. 253, 59 Adt. 58 (1904);
Washington Grove Ass'n v. Walker, 128 Md. 85, 96 Atl. 1079 (1916);
Ace Bus Transport Co. v. South Hudson Bus Owner's Ass'n, 118 N.J. Eq. 31, 177 Atl. 360 (1935). Where a corporation originally managed by five directors as provided in the by-laws
found and the by-law is held not amended, but superseded pro tanto, or waived, as to the particular transaction. When found waived, the by-law remains absolutely unimpaired and any subsequent inconsistent contract will be subject to it unless such subsequent contract also amounts to a waiver.

Whether the theory be waiver or amendment, the courts cannot uphold the contract vis à vis the by-law unless the directors not only have the power to amend, but the power to amend informally. The directors have power to amend informally when they have power to change and thus disregard not only the by-law, but the amending procedure as well. Whether the directors possess this power turns on two considerations: whether the charter or by-laws set out the amending procedure and who, if anyone, has a valid expectancy that the amending procedure not be changed without his consent.

The power to amend and the prescribed method of exercising that power may be embodied in the corporate charter or the by-laws. If the corporate charter prescribes the method of amending the by-law, the directors cannot amend or waive except in substantial compliance with the prescribed method. If the method of amending the by-laws had for many years since functioned under three directors, the court found that "the by-law requiring a board of five was changed by the unanimous (implied) consent of the stockholders . . . the act of incorporation being silent as to the number of directors, and the statute . . . being satisfied with a board of that number." Buck v. Troy Aqueduct Co., 76 Vt. 75, 77, 76 Atl. 285, 286 (1903).

"I am of the opinion and find that the contract made by the defendants pursuant to the express authority of its board of directors, which had express power to amend at will the by-laws of the defendant, modified, in its legal effect, all inconsistent by-laws and prevails over them." Realty Acceptance Corp. v. Montgomery, 51 F.2d 636, 639 (3d Cir. 1930). See Community Stores, Inc. v. Dean, 1 Terry 566, 14 A.2d 623 (Del. 1940); Mathews v. Fort Valley Cotton Mills, 179 Ga. 580, 176 S.E. 505 (1934); Hill v. American Co-op. Ass'n, 195 La. 590, 197 So. 241 (1940); Pomeroy v. Westaway, 273 App. Div. 760, 70 N.Y.S.2d 449 (App. Div. 1947). See generally FLETCHER, CORPORATIONS § 4200 (perm. ed. 1931); MACHEN, CORPORATIONS § 728 (1908).

"Moreover, statute and charter provisions expressly forbidding waiver have been upheld. McCurry v. The Practorians, Inc., 90 S.W.2d 853 (Tex. Civ. App. 1936); Sovereign Camp, W.O.W. v. Todd, 283 S.W. 659 (Tex. Civ. App. 1926)."


Unless the charter provision is considered to be in the nature of a contract with the state, the directors can waive a by-law in spite of a prescribed amending procedure in
is set out in the by-laws themselves, many courts have answered the question of whether the directors can disregard the procedure by determining whether the directors or the stockholders have original power to adopt by-laws. If the directors adopted the original by-laws or if the stockholders adopted the original by-laws and then delegated the power to amend to the directors without specific directives as to how the power should be exercised, these courts hold that the directors need not strictly adhere to the amending procedure set out in the by-law. Otherwise, the directors have power to amend only by the prescribed procedure. The real relevancy of these considerations lies in their bearing on the question of the extent to which the by-law constitutes a contract establishing the relationship between the stockholders and the directors or among the stockholders inter se. If the by-law is found to be in the nature of a contract, the stockholders have a vested right that the amending procedure be strictly adhered to. But if the by-law was drawn merely to expedite the handling of business, no one can object that the directors saw fit to disregard the suggested procedure. 

the charter, if the shareholders knew all the material facts and acquiesced in the violation. Here we see the amendment theory at the next higher level. If the stockholders can unilaterally amend the charter, they can, under proper circumstances, amend it (except to the extent that it is a public record) by implication when they acquiesce in director violations. This acquiescence may be formal or implied by the acceptance by the corporation of benefits derived from the violation. In other words, the stockholders can waive their right that the directors not waive the by-law informally. Underhill v. Santa Barbara Land, Bldg. & Improvement Co., 93 Cal. 200, 28 Pac. 1049 (1892). 

21 TEX. BUS. CORP. ACT art. 2123 (1956), vests power to adopt by-laws in the stockholders unless and to the extent that the incorporators vest this power in the directors by the terms of the articles of incorporation. 

22 Dorens v. Supreme Lodge Knights of Pythias, 75 Miss. 466, 23 So. 191 (1898); Richardson v. Union Congregational Soc’y, 58 N.H. 187 (1877); Smith v. Nelson, 18 Vt. 511 (1846); see generally Annot., 169 A.L.R. 1374 (1947), to the effect that the director’s power to waive the by-laws informally is not vitiated by the mere existence of a formal amending procedure in the by-laws. 


24 Loewenthal v. Rubber Reclaiming Co., 52 N.J. Eq. 440, 28 Atl. 454 (1894) (calling such by-law “fundamental by-laws”). If the by-law is in the nature of a contract, the stockholder may be found to have a property right that the by-law be amended only by the prescribed method of amending, Schood v. Hotel Easton Co., 369 Pa. 486, 87 A.2d 227 (1952). 

25 Whether a by-law is in the nature of a contract or more in the nature of an operating procedure for the convenience of the directors is a question of fact in the establishment of which consideration should be given to the intent with which the framers instituted the by-law. See generally FLETCHER, CORPORATIONS § 4195 (perm. ed. 1931).
Once decided that the directors have power to amend the by-laws and to do so without strict adherence to a prescribed formality, the courts must turn to the question of the intent with which the directors approved the contract. It is generally held that the directors must have been aware of the facts that afford pertinency to the by-law and must have intended that the contract affect the legal rights of the corporation in the manner it did before they can be said to have waived the by-law. To illustrate, if the directors of the Dixie Glass Company had negligently made a five year contract thinking that it was for only one year, the inconsistent by-law would not have been waived and the contract would not have been binding. But there is another and seemingly over-conceptualistic view that a contract made with knowledge of an inconsistent by-law will be held subject to the by-law on the theory that one who contracts with knowledge of a by-law is conclusively presumed to have intended to incorporate its terms into the contract. Officers, stockholders, and others who were “insiders” at the time the contract was executed, like the plaintiff in the Dixie case, are charged with constructive notice of the contents of the by-laws. “Outsiders,” however, can enforce their contracts against the company unless they contracted with actual knowledge of the inconsistent by-law.

There are several cogent reasons for caution in the recognition of informal amendment or waiver of the by-laws by contract. When the formal amending procedure is disregarded, the policy behind the offended by-law is less likely to be examined and weighed against the values to be derived from the proposed contract. Furthermore, if one of the directors is not present when the contract is voted upon, especially if he is entitled to notice when an amendment to the by-laws is contemplated, he is denied an opportunity to be heard and to gain support for adherence to the by-law. To say that the absent director...

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27 Underhill v. Santa Barbara Land, Bldg. & Improvement Co., 93 Cal. 306, 28 Pac. 1044 (1892).
31 See generally O'Neal, Close Corporations § 8.02 (1958).
waived his right to be heard discounts the fact that the corporation is
denied the benefit of his views on the proposed action.

Nevertheless, the need for giving validity to informal amendment
by contract seems to outweigh the possible dangers. Many of the argu-
ments against informal amendment should be directed to the question-
able wisdom of by-laws amendable by a simple plurality of the direc-
tors. Moreover, as long as small businesses must operate under the
same corporation statutes that serve large, public-issue corporations, some
consideration must be given to the small corporation's peculiar need for
quick, convenient and inexpensive director action. Many businessmen
who utilize the corporate form do not appreciate the need for formality
and others simply refuse to perform seemingly non-productive ritual.
The placing of a premium on corporate formality serves only to render
uncertain the validity of the informal procedures inevitably utilized by
small businessmen.

Two months before the Dixie case was heard, the Texas Supreme
Court reversed this same appellate court on a very similar fact situation
and held the employment contract to be invalid. In that case it does
not appear that the theory of informal amendment by inconsistent con-
tract, successful in the Dixie case, was urged. If the Dixie case comes
before the Texas Supreme Court on appeal, it would clarify the law and
serve the needs of business for that court to recognize the concept of
informal amendment. However, the court should circumscribe its
application to situations where the directors have full power to amend
and to amend informally, where the directors intended that the corpora-
tion be bound in the way the contract is interpreted, and where undue
violence is not done to the status of the by-laws within accepted cor-
porate norms.

82 "The evil possibilities suggested have their true foundations not in the supremacy
of contract over by-law, but in the futility of a limitation which rests solely upon a
by-law amendable by a majority of the board." Realty Acceptance Corp. v. Mont-
gomery, 51 F.2d 626, 629 (3d Cir. 1930).
83 See generally O'Neal, CLOSE CORPORATIONS §§ 1.12-1.15 (1958).
84 Pioneer Specialties Inc. v. Nelson, 339 S.W.2d 199 (Tex. 1960), summarized in
note 9 supra.