Buffalo Law Review

Volume 8 | Number 1 Article 44

10-1-1958

Corporations—Authority of President to Commence Arbitration

Buffalo Law Review

Stockholders' Consent for Sale of Realty

Section 20 of the Stock Corporation Law requires the consent of two-thirds of the stockholders in a sale of substantially all the assets of the corporation *not* made in the regular course of business. Past decisions hold that the regular course of business is the business that the corporation was actually carrying on prior to the sale and not what the corporate charter authorized.[7] In *Eisen v. Post*,[8] when the directors sold all of the corporate assets without the consent of its stockholders, the corporation's actual business was an ultra vires activity. Although the sale was authorized by the corporate charter the stockholders brought an action to set the sale aside on the ground that section 20 was applicable. Relying on past decisions the stockholders claimed that the sale was not made in the regular course of business because the regular course of business was what the corporation actually had been carrying on. The Court held that an ultra vires activity cannot be the regular course of business under section 20 and therefore the charter must control. In so holding the Court did not overrule the past decisions which make actual business controlling but made the distinction that the actual activity carried on in past cases was authorized.

The Court based its decision upon the theory that third persons who rely on the charter of the corporation with which they deal should be protected. however it refused to disavow the general rule and made the charter controlling only where the actual business is ultra vires. Therefore outsiders still may not rely upon the corporate charter. They must still find out which of the authorized businesses are actually being carried on in order to protect themselves against voidability. Since they cannot know the actual business to be ultra vires without first finding what the actual business is, the holding of this case is of no protection to them unless they have failed to exercise the usual care required to protect themselves by investigating and the actual business turns out to be ultra vires. The kind of protection thus afforded by the present case is a windfall and is not required by reason or authority.

A more realistic basis for the holding is that since the stockholders can have no legitimate interest in the continuation of an ultra vires business, there is no reason to give them relief under section 20.

Authority of President to Commence Arbitration

The Court was again this term presented with the question of the power

7. In re Kunin, 306 N.Y. 967, 120 N.E.2d 228 (1954); Hodes v. 1299 Realty Corp., 278 App. Div. 803, 104 N.Y.S.2d 206 (1st Dep't 1951).
8. 3 N.Y.2d 518, 169 N.Y.S.2d 15 (1957).

of a corporate officer to institute legal action for his corporation.[9] In *Paloma Frocks, Inc. v. Shamokin Sportswear Corp.*[10] the corporation's president, under the terms of a contract of his corporation, served a demand upon the other contracting party for arbitration of an alleged breach of contract without first securing the approval of his board of directors, half of which represented the other contracting party and presumably would have opposed the action had it been submitted to the Board. On this application for a stay of arbitration, *held*: the president had the requisite authority to institute the action.[11]

The power to do business, including corporate litigation, is vested primarily in the board of directors.[12] However, it is by now well settled that, in the absence of an express proscription by the charter, by-laws, or board of directors, the president has *prima facie authority to initiate litigation.*[13] This power is implied by the rules of agency where the president has been given general management of the corporate business and the litigation is a part of the general business of the corporation.[14]

Because the authority is not inherent in the office, it follows that the board may revoke it at any time. Thus, in *Sterling Industries v. Ball Bearing Pen Corp.*,[15] a 1949 decision, where the president had consulted the board and it, by a deadlock vote, rejected the proposal to litigate, it was held that whatever implied authority the president had previously possessed was taken from him by the board's rejection and he could not later commence action on his own initiative. The mere fact of deadlock by the board does not invest the president with power to act since equal representation on the board is a valid means of control for contending factions and since there was an adequate alternative remedy for the president, to wit: a stockholder's derivative action initiated by him in his capacity as stockholder.

9. The Court in the 1956 term found the necessary authority for a corporation's secretary-treasurer, who was the general manager of the business. *See* Rothman and Schneider v. Beckerman, 2 N.Y.2d 493, 161 N.Y.S.2d 118 (1957) and Note *Power of Corporate Officers to Institute Litigation,* 7 BUFFALO L. REV. 102 (1957).

10. 3 N.Y.2d 572, 170 N.Y.S.2d 509 (1958).

11. Paloma Frocks Inc. v. Shamokin Sportswear Corp., 3 N.Y.2d 572, 170 N.Y.S.2d 509 (1958).

12. N. Y. GEN. CORP. LAW §27; N. Y. STOCK CORP. LAW §60; Koral v. Savory, 276 N.Y. 215, 217, 11 N.E.2d 883, 884-885 (1937).

13. Twyeffort v. Unexcelled Mfg. Co., 263 N.Y. 6, 188 N.E. 138 (1933); 2 FLETCHER, CYCLOPEDIA OF CORPORATIONS §618 (Perm. ed., Rev. vol. 1954).

14. *Ibid. See also* Rothman & Schneider, Inc. v. Beckerman, *supra,* note 1. Although there is little authority in New York, it would seem on principle that the president has power to sue for the corporation where its interests demand action to avoid immediate or vital injury and the board of directors, *acting in bad faith,* has refused authority. Recamier Mfg. Co. v. Seymour, 15 Daly 245, 5 N.Y. Supp. 648 (1889); Elblum Holding Corp. v. Mintz, 120 N. J. L. 604, 1 A.2d 204 (1938). (Such evidentiary facts were not present in *Sterling Industries v. Ball Bearing Pen Corp., infra,* note 7, or in the instant case, *supra,* note 3.)

15. 298 N.Y. 483, 84 N.E.2d 790 (1949).

The Court distinguished *Sterling* from the instant case because in the latter instance (1) the initiation of litigation was never submitted to the board for approval and (2) demanding arbitration under the contract clause amounted to no more than the routine performance of a contract, within the president's general management authority; although the board could have expressly forbidden submission of a particular disputes to arbitration, it had not done so.[16]

The distinction drawn seems somewhat fine. The inclusion of a general arbitration clause in a contract should settle the *form* of remedy between the contracting parties.[17] However, the question whether to press a particular claim involves policy considerations traditionally left to the business discretion of the board of directors, subject to the director's fiduciary duty to shareholders.[18] That the proposed litigation is to be by arbitration rather than by adjudication should not affect this.

The case seems to rest on the factual distinction that here the proposed action was not submitted to the board and suggests that if a corporation general managing officer, facing a deadlocked board, acts on his own initiative without consulting the board, his action will be sustained even if he knew that he could not have obtained approval from the board. This, it is submitted, is not in keeping with the policy of the statute[19] or the well-reasoned rationalia of the *Sterling* decision.[20]

Membership Corporations—Requirement for Membership Approval

Approval not having been obtained from the Supreme Court of a lease entered into by a membership corporation as required by section 21 of the Membership Corporation Law,[21] this proceeding was brought by the lessee thereunder for its confirmation.[22] The lease had been approved by the board of directors of the corporation with the requisite quorum present. However, the evidence established that the scheme of the by-laws indicated an intent that every decision of the organization, not purely ministerial in nature, be made by a majority vote of the members. Thus, the lease was not validly entered into by the corporation in the first place, and there was nothing for the Court to approve.

16. Paloma Frocks, Inc. v. Shamokin Sportswear Corp., 3 N.Y.2d 572, 170 N.Y.S.2d 509 (1958).

17. N. Y. CIV. PRAC. ACT Art. 84.

18. Koral v. Savory, 276 N.Y. 215, 11 N.E. 883 (1937); Posts v. Buck's Stove & Range Co., 200 Fed. 918 (8th Cir. 1912).

19. N. Y. GEN. CORP. LAW §27.

20. Sterling Industries v. Ball Bearing Pen Corp., 298 N.Y. 483, 84 N.E.2d 790 (1949).

21. "No sale or mortgage . . . of real property within the state, or lease thereof for more than five years, shall be made without leave of the supreme court in a judicial district in which some of the property is located, or the county court of the county wherein the property is wholly or partly situated. . . . If [a lease has been entered into without approval], the court . . . may confirm such . . . lease, subject to the intervening rights, if any, of subsequent bona fide purchasers and mortgages of record."

22. In re Trapasso Oldsmobile, Inc., 4 N.Y.2d 133, 173 N.Y.S.2d 10 (1958).