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Business Associations—Corporations

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e. Conclusions of law: In *Golden v. Joseph,*[80] city employees under the civil service designation of "stationary firemen" brought an action under § 220 of the Labor Law demanding fixation of their wages at the prevailing rate under that section. The New York City Comptroller dismissed the petitions on the ground that petitioners' employment was not such as to bring them within the statutory definition of laborers, workmen or mechanics employed in the construction, maintenance or repair of public works.[81] The Appellate Division affirmed.[82]

The Court of Appeals, *per* Judge Desmond, unanimously reversed this determination on the ground that it was error to exclude evidence that these employees actually did make repairs on buildings though their classification did not specifically call for it, and hence, since they did in fact make such repairs, they did have a right to a wage fixation under §220. It is true that the test of whether or not a city employee is engaged in construction, maintenance or repair of public works is the municipal civil service description of his job duties,[83] but the designation of "stationary firemen" encompassed such work as was embraced by the statute. The Comptroller, in finding otherwise, had hence misconstrued the statute.

II. Business Associations

Corporations

a. *Right of appraisal:* Section 21 of the Stock Corporation Law provides procedures for the determination of the value of the stock of a stockholder objecting properly to various kinds of action by the corporation.[1] The corporation may make an offer to purchase the objector's stock. If it does not do so, or the stockholder fails to accept the offer, the stockholder of the corporation may petition the Supreme Court to determine the value. "Such petition shall be made returnable on the fiftieth day after the last day on which the demand of the objecting stockholder for payment might have been made . . ." Certain recapitalizations[2] are subject to

80. 307 N. Y. 62, 120 N. E. 2d 162 (1954).
81. Labor Law § 220(2).
82. *Golden v. Joseph,* 281 App. Div. 655, 117 N.Y.S. 2d 653 (1st Dep't 1952).
83. *Flannery v. Joseph,* 300 N.Y. 149, 89 N.E. 2d 869 (1949).

1. A right of appraisal arises under Stock Corporation Law § 14 (issue of stock to employees in derogation of preemptive rights); § 20 (sale of assets); § 85 (merger); § 91 (consolidation); Art. 4, especially § 38(11) (amendment of certificate of incorporation); § 105 (dissolution).
2. Stock Corporation Law § 38(11).

the right of appraisal under Section 21, providing that those not in favor of such action object and demand payment "prior to the vote authorizing such action."

In re McKinney,[3] dealt with a petition for appraisal by stockholders objecting to a proposed plan of recapitalization. The plan included the provision that it was to go into effect only if and when the directors declared the plan operative.

Before the plan was approved by the stockholders on Nov. 26, 1951, the McKinneys filed their petition and demanded payment. On April 7, 1952, the directors declared the plan to be operative. On May 1, 1952, the McKinneys filed their petition for appraisal, more than fifty days after the stockholders vote, but fewer than fifty days after the directors' decision.

The court, in a four to three decision, affirmed the order dismissing the petition holding: the vote referred to in Sections 21 and 38 of the Stock Corporation Law is the vote of the stockholders, and the 50 days commences to run from that day even though the dissenters could not know until the declaration by the directors that the plan, to which they objected, would be put into effect. The court felt itself bound by a strict reading of the statutes and suggested that better protection for dissenting stockholders would have to be given by the Legislature.

In a strong and cogent dissent, Fuld argues that since in charter amendments such as this, the statute clearly requires a stockholder vote "authorizing" the change, and does not provide for delegation to the directors of the power to make the change operative, the Legislature intended to exclude the directors from such a discretionary determination. Since the Legislature intended the fifty days to run from the stockholders' vote where that vote was to be conclusive, where as here the conclusive vote was the declaration by the directors, and not by the stockholders, the fifty days should run from the date of the directors' declaration.

Rights of appraisal under Section 21 also apply where a stockholder objects to a voluntary sale of corporate property[4] or to the exchange of the corporation assets for stock of another corporation under a voluntary dissolution.[5]

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3. 306 N.Y. 207, 117 N.E. 2d 256 (1954).
4. Stock Corporation Law § 20.
5. *Id.* § 105(9).

If the sale or exchange is within the statutory framework, the objecting stockholder is limited to his right of appraisal and may not enjoin the transaction.[6]

In *Eisenberg v. Central Zone Property Corporation*,[7] the court, on finding that the proposed plan was not within the statute, decided that an objecting stockholder was not limited to his right of appraisal and did enjoin the transaction.

Here the corporation proposed to transfer all of its assets (real property in New York City) to a Delaware corporation to be formed, in exchange for all of the stock of the Delaware corporation. This stock was to be deposited in a voting trust pursuant to a voting trust agreement giving the trustees power to elect directors of the Delaware corporation and to sell all of the stock of the Delaware corporation. The stockholders of the New York corporation were to exchange their stock for certificates of the voting trust; then the New York corporation was to be dissolved.

Further complications are involved, but on these facts, the court needed no authority, other than the statutes, to decide for the plaintiff—objecting stockholder, and block the plan. Judge Fuld's concurring opinion amply disposes of the problem; "The series of transactions contemplated . . . involve far more than a sale or conveyance within the statute."

b. *Security in derivative actions:* Section 61b of the General Corporation Law provides that, "In any action instituted or maintained in the right . . . of a corporation . . . by the holder of less than five percent of the outstanding shares of any class of the corporation's stock unless the shares . . . have a market value in excess of $50,000.00, the corporation, in whose right such action is brought shall be entitled . . . to . . . require the plaintiffs . . . to give security . . ."

In *Gordon v. Elliman*,[8] a holder of less than five percent of the stock worth less than $50,000.00 brought suit against the corporation and its directors to compel a dividend payment. No dividends were guaranteed on the stock.

Defendant moved under Section 61b of the General Corporation Law to require plaintiff to post security.

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6. *Beloff v. Consolidated Edison Co. of N. Y.*, 300 N. Y. 11, 87 N. E. 2d 561 (1949) and other cases cited in *Eisenberg v. Central Zone Property Corp.*, 203 Misc. 59, 116 N. Y. S. 2d 154 (Sup. Ct. 1952).
7. 306 N. Y. 58, 115 N. E. 2d 652 (1953).
8. 306 N. Y. 456, 119 N. E. 2d 331 (1954).

Van Voorhis, speaking for a majority of the Court, held for the defendant, deciding that a suit against a corporation and its directors to compel declaration of dividends is an action in the right of the corporation.

The only prior New York decision directly in point is *Swinton v. Bush*,[9] which held just the opposite—that a suit to compel declaration of dividends is not in the right of the corporation and not within 61b. Authorities and decisions in other jurisdictions and prior dictum in New York are in hopeless conflict on this point.[10]

The court distinguished cases where the stockholder could sue at law to recover dividends already declared,[11] or dividends guaranteed,[12] and laid down the general proposition that an action "is in the right of the corporation which involves the equitable powers of the Supreme Court to direct the management of its affairs." "A stockholder has no individual cause of action to recover dividends that have not been declared." All that he can do, is to sue in equity to cause the court to perform a corporate function which the directors would have done except for bad faith.

Rejecting the argument that the interests of the stockholder were opposed to those of the corporation where dividend payments are concerned, Van Voorhis observed that the failure of the directors properly to declare dividends may be a wrong to the corporation because of the difficulties of getting fresh capital and the penalty provisions of the Internal Revenue Code.[13]

Fuld, in his dissent, argues that though it may be in the *interest* of the corporation to declare dividends, the General Corporation Law concerns the *right* of the corporation, and contends that the right to have dividends declared is one of the incidents

9. 119 Misc. 321, 102 N.Y.S. 2d 994 (Sup. Ct. 1951), *aff'd* 278 App. Div. 754, 103 N.Y.S. 2d 1019 (1st Dep't 1951).

10. *Compare Lydia E. Pinkham Medicine Co. v. Grove*, 303 Mass. 1, 20 N.E. 2d 482 (1939); *Jones v. Van Heusen Charles Co.*, 230 App. Div. 694, 246 N.Y. Supp. 204 (3d Dep't 1930); FLETCHER, CORPORATIONS (Rev. ed. 1932) § 5326, *with* BALANTINE, CORPORATIONS (Rev. ed. 1946) § 234, *Kranich v. Bach*, 209 App. Div. 52, 204 N. Y. Supp. 320 (1924); *Stevens v. U. S. Steel Corporation*, 68 N. J. Eq. 373, 59 A. 905 (1905).

11. *Godly v. Crandall & Godly Co.*, 212 N.Y. 121, 127, 105 N.E. 818, 820 (1914).

12. *Boardman v. Lake Shore and Michigan Southern Ry. Co.*, 84 N.Y. 157 (1881).

13. INT. REV. CODE, § 102. "There shall be levied . . . (in addition to other taxes . . .) upon the net income of every corporation . . . if such corporation . . . is availed of for the purpose of preventing the imposition of the surtax upon its shareholders, through the medium of permitting earnings of profits to accumulate instead of being divided or distributed, a surtax equal to the sum of the following: 27½% of the amount of the undistributed section 102 net income not in excess of $100,000, plus 38½% of the undistributed section 102 net income in excess of $100,000."

of stock ownership belonging to the individual stockholder, not to the corporation.

c. *Right to reimbursement:* Section 64 of the General Corporation Law provides that "any person made a party to an action by reason of the fact that he is a director, officer or employee of a corporation shall be entitled to have his reasonable expenses . . . incurred in connection with the defense of such action . . . assessed against the corporation . . . *except in the relation to matters as to which it shall be adjudged in such action . . . that such officer, director or employee is liable for negligence or misconduct* in the performance of his duties." [Emphasis added.]

In the recent case of *Diamond v. Diamond,*[14] an individual defendant who had won a verdict in a derivative suit, moved to receive from the corporation the reasonable expenses incurred pursuant to Section 64.

The verdict in the derivative suit had gone to the defendant.[15] The trial court had found that the individual stockholder bringing the suit was a party to the alleged wrongs of the defendant and as she could not recover individually, she could not redress those wrongs in a derivative suit.[16] Upon motion by the defendant under Section 65, the trial court awarded expenses under Section 67, finding in the words of that section that the applicant was "successful in whole or in part."[17] Judge Di Falco of Special Term, after a review of the history of Article VI-A, concluded that "adjudged liable" in Section 64 taken in conjunction with "successful in whole or in part" of Section 67 means a judgment entered on a decision.

A majority of the court, in an opinion by Judge Desmond, narrowed the scope of Section 64 by broadening the concept of "adjudged liable."[18] It held that the intent of the Legislature was not to award expenses to faithless officers and directors, and therefore, "adjudged liable" should be construed to mean a finding by a court, and not only a judgment.

d. *Voluntary dissolution:* Article 9 of the General Corporation Law deals with proceedings for voluntary dissolution of a domestic corporation.

14. 307 N.Y. 263, 120 N.E. 2d 819 (1954).
15. *Diamond v. Diamond,* 200 Misc. 1055, 107 N.Y.S. 2d 508 (Sup. Ct. 1951).
16. See *Capital Wine & Spirit Corp. v. Pokrass,* 302 N.Y. 734, 98 N.E. 2d 704 (1951).
17. *Diamond v. Diamond,* 200 Misc. 1074, 108 N. Y. S. 2d 864 (Sup. Ct. 1951).
18. The scope of Art. 6-A was previously restricted by excluding defenses of criminal actions. *Schwartz v. General Aniline & Film Corp.,* 305 N.Y. 395, 113 N.E. 2d 533 (1953). See 3 BFLO. L. REV. 62 (1953).

Section 103 provides that if there is a deadlock between directors, or between stockholders as to the election of directors, the holders of one-half of the stock may petition for dissolution. Under Section 106, the court may entertain or dismiss the application. When it entertains the application, the "court must make an order requiring all persons interested to show cause before it, or a referee, why the corporation should not be dissolved." Section 113 declares that the court or referee must hear allegations and proofs and determine the facts. Finally, under Section 117, if "it shall appear . . . that a dissolution shall be beneficial to the stockholders and not injurious to the public . . . the court must make a final order dissolving the corporation . . . ."

In a recent case, In re *Radom & Neidorff, Inc.*,[19] there was a deadlock between stockholders as to election of directors. Special Term entertained an application for dissolution and appointed a referee to hear and report. Before the hearing, the matter was appealed to the Appellate Division which dismissed the application.[20]

By a four to three vote, the Court of Appeals affirmed the dismissal, holding that for there to be a basis for dissolution, the deadlock must not only prevent election of the Board of Directors, but it must also impair the day to day functioning of the corporation and impair its economic well-being.

Radom & Neidorff was a family corporation owned equally by a brother and sister who hated each other. The brother was the sole officer of the corporation and completely managed its affairs except that the sister had to co-sign all corporation checks. She had refused for some time to sign his salary checks and had instituted a derivative suit charging him with enriching himself at the corporation's expense. However, the corporation had been steadily piling up profits since the deadlock and was in good financial shape.

Upon these facts, the court held that the dismissal of the petition was within the discretion of the Appellate Division. Following *Matter of Cantelmo*,[21] the court implied that if the corporation's economic well-being is not impaired, it is not to the benefit of the stockholders qua stockholders (and not qua individuals) to dissolve.

Fuld's dissent, in which Lewis and Froessel concurred, maintained that whether or not the stockholders would benefit should

19. 307 N.Y. 1, 119 N.E. 2d 563 (1954).
20. 282 App. Div. 854, 124 N.Y.S. 2d 424 (1st Dep't 1953).
21. *Matter of Cantelmo,* 275 App. Div. 231, 88 N.Y.S. 2d 604 (1st Dep't 1953).

be determined by the hearing, and not from the petition itself, once there was the showing of a deadlock, as there was here. Furthermore, the minority refused to expand the statutory language of "deadlock" into "deadlock causing economic impairment."

Also under Article 9, Special Term, in the case of In re *Seamerlin Operating Co.*,[22] entertained the application of the owner of one half of the stock for dissolution of the corporation. Instead of hearing the case itself, or referring it to a referee to "determine" the facts under Section 113, Special Term referred it to a referee to "hear the facts and make his report to the Court."

After lengthy hearings, the referee reported that "the dissolution would not be beneficial to the stockholders . . . and (pursuant to Section 117) the petition for dissolution should be denied." Special Term however, upon application for a final order disagreed with the referee's findings that dissolution would not be beneficial to the stockholders and ordered dissolution.[23]

This order was affirmed by the Appellate Division,[24] but the Court of Appeals reversed,[25] Desmond, Fuld and Froessel dissenting. The court held that the statutory provisions were exclusive—since Section 113 provided that the referee was to hear and determine the facts, which determination would be binding on the trial court, the court could not make a referral which would not be binding by purporting to refer only to hear and report. The trial court in its final order under Section 117, must follow the findings of the referee, unless as a matter of law, they are unsubstantiated.

Desmond's dissent argues that even if the Legislature provided for the use of a referee to make binding determinations, that would not preclude the use of a referee merely to report the facts as in "all other special proceedings."

e. *Power of stockholders to remove directors:* Even though the certificate of incorporation of a New York corporation provides that for cause shown and upon proper notice and hearing, a director may be removed by the majority of the other directors in office, and the certificate is silent as to the right of the stockholders to remove directors, the stockholders do have the power to remove directors at any time, for cause shown and upon proper notice and hearing.

22. 131 N.Y.S. 2d 174 (Sup. Ct. 1954).
23. *Id.*
24. 130 N.Y.S. 2d 865 (1st Dep't 1954).
25. 307 N.Y. 407, 121 N.E. 2d 392 (1954).

This recent decision of the court in *Auer v. Dressel*,[26] resulted from a refusal of a corporation president to call a special stockholders' meeting as prescribed in the by-laws, on the grounds that none of the four purposes of the meeting was a proper one. The crucial purpose was that the "stockholders should hear charges preferred against four of the directors, determine whether their conduct was inimical to the corporation, and if so, to vote for their removal and vote for the election of their successors."

Without deciding the question of whether adequate hearing could be had before 1500 stockholders or their proxies, the court held that such is a proper purpose for a stockholders' meeting.

Previous New York cases have held that stockholders cannot remove directors without good cause,[27] but that if cause is shown, the stockholders have the inherent power even without specific statutory authorization to remove directors.[28] This appears to be the first New York case to hold that the stockholders retain the power although it is also given to the Board of Directors.

Van Voorhis' dissent, in which Conway concurs, argues that the directors can be removed only after full and fair trial, either under Section 60 of the General Corporation Law, or according to the by-laws, by the remaining directors. If a meeting is called for the stockholders to vote on removal, most stockholders would be represented by proxy and could vote only by prejudging the case. This would amount to the removal of directors by whim and not for good cause as the law requires.

The court's answer to this is that the fairness of the proceedings is not now before it, and if any director is illegally removed, he has remedy in the courts.[29]

Fiduciary Duty of Employees

It is a breach of the fiduciary duty owed by the employee to the employer for the employees to act in any way inimical to the interests of the employer to serve their own interests.[30]

In *Duane Jones Co., Inc. v. Burke et al.*,[31] the Court of Appeals illustrated this principle by affirming an award of damages to an employer—advertising agency against former key employees. While still employed by the plaintiffs, the defendants made

26. 306 N. Y. 427, 118 N. E. 2d 590 (1954).
27. *People ex rel. Manice v. Powell*, 201 N.Y. 194, 94 N.E. 634 (1911).
28. In re *Koch*, 257 N.Y. 318, 321, 322, 178 N.E. 145, 146 (1931).
29. *Ibid.*
30. See *Byrne v. Barrett*, 268 N.Y. 199, 197 N.E. 217 (1935), *Lamdin v. Broadway Surface Advertising Co.*, 272 N.E. 133, 5 N.E. 2d 66 (1936).
31. 306 N.Y. 172, 117 N.E. 2d 237 (1954).