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Corporations—Expenses of Proxy Fight

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Expenses of Proxy Fight

The Court of Appeals was faced with a stockholders derivative action against a corporation and its past and present directors, for money spent by the corporation to defray the expenses of rival factions in a proxy fight, in *Rosenfeld v. Fairchild Engine and Airplane Corp.*[1] The old board spent $106,000 while still in office in defense of their position; they were paid the $28,000 balance by the new board after the election and $127,000 was paid for the reimbursement of expenses of the victorious insurgent group. This latter expenditure was ratified by a 16 to 1 stockholder vote. Judge Froessel, writing for the majority, *held,* that the stockholders were not entitled to recovery, in the absence of challenge by them of specific items which could have been found unwarranted, excessive or otherwise improper. His opinion was based on: (1) the fact that the plaintiffs admitted the charges were fair and reasonable (although they denied that they were legal and reimbursable), (2) directors have a right to protect their position and solicit proxies in a dispute over policy, and (3) the overwhelming vote of stockholder ratification justified the repayment of the insurgent group.

The leading Court of Appeals case in this area has held that a solicitation for the benefit of one faction seeking to *perpetuate themselves in office* should not be charged to the corporation.[2] However, more recent New York lower court decisions and courts of other jurisdictions have held that management may look to the corporate treasury for the reasonable expenses of soliciting proxies to defend its position in a bona fide *policy contest.*[3] A recent federal case based on Delaware law approved the reimbursement of the successful "out" faction after a policy fight, when the expense was approved by the stockholders.[4]

Judge Desmond, in a concurring opinion, agreed with the majority in result but contended that the plaintiffs should lose merely because they failed to segregate the expenses which they regarded as unlawful[5]. It was his opinion that such portion of the expenses as were designed to perpetuate the directors in office were unlawful and could not be ratified.

In a vigorous dissent, concurred in by Judges Dye and Fuld, Judge Van Voorhis argued that *all* of the expenses incurred were not for the mere information of the stockholders and the burden of proving the propriety of the excess expense

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1. 309 N. Y. 168, 128 N. E. 2d 291 (1955).
2. *Lawyers Advertising Co v. Consolidated Ry., Lighting and Refrigerating Co.,* 187 N. Y. 395, 80 N. E. 199 (1907).
3. *Matter of Zickl,* 73 N. Y. S. 2d 181 (1947); *Hall v. Trans-Lux Daylight Picture Screen Corp.,* 20 Del. Ch. 78, 171 Atl. 226 (1934).
4. *Steinberg v. Adams,* 90 F. Supp. 604 (S. D. N. Y. 1950).
5. *Supra,* note 2.

should be placed on the directors. Citing the *Lawyers Advertising* case, he stated that expenses beyond those of informing and securing a quorum of stockholder proxies were *ultra vires* and it is impossible to ratify an *ultra vires* act by majority vote.[6] The "personal v. policy" test was also criticized, as personal aspirations for control of a corporation are often presented under the guise of a policy matter. Finally, Judge Van Voorhis believed that the majority result of "to the victors belong the spoils" could easily lead to proxy fights being waged by irresponsible groups of minority adventurers.

It seems quite evident, from a study of all three opinions, that had the plaintiffs been more particular in their complaint and segregated the portions of the expense which they considered excessive and illegal they would have been allowed a partial recovery. Due to the widespread stockholdings of modern business corporations, the directors must be allowed considerable latitude in spending money to adequately inform all stockholders of basic issues. However, in a situation like the present case, where there is a full scale campaign being waged by each side, it seems unreasonable for the corporation to bear the whole burden of the expense, for reasons very well expressed by the dissenting opinion.

Director's Right to Examine Books

The Court considered the problem of the inspection of corporate books in *Cohen v. Cocoline Products.*[7] A non-stockholding director brought a proceeding in the nature of mandamus at Special Term for inspection of the corporate books and records.[8] While a motion for reargument was pending, a stockholders' meeting was held, and the director was removed from office. Nevertheless, the order was granted on the basis of pleadings and affidavits only. Judge Froessel, speaking for the majority, held that the issuance of the order on this basis was error, and that issues of fact, raised by the answering papers, should be remitted to Special Term for further proceedings.

A director has an absolute and unqualified right to inspect the corporate books, but such right terminates when an applicant for such order is removed as director while his application is pending before Special Term.[9] A stockholder has a qualified right, in the discretion of the Supreme Court, to protect his financial interest in a corporation by an inspection of its books and records.[10]

6. *Continental Securities Co. v. Delmont,* 206 N. Y. 7, 99 N. E. 138 (1912).
7. 309 N. Y. 119, 127 N. E. 2d 906 (1955).
8. C. P. A., Article 78.
9. *Overland v. LeRoy Foods,* 279 App. Div. 876, 110 N. Y. S. 2nd 578 (2nd Dep't 1952), *aff'd,* 304 N. Y. 573, 107 N. E. 2d 74 (1952).
10. STOCK CORPORATION LAW, § 10; *Matter of Steinway,* 159 N. Y. 250, 53 N. E. 1103 (1899).