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Corporations—Director's Right to Examine Books

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THE COURT OF APPEALS, 1954 TERM

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).

The majority held that the absolute right of the petitioner to compel inspection ended with his removal from office. They granted him the opportunity to assert a possible qualified right of inspection at further proceedings, however, on the grounds of his potential liability for wrongful acts of the directors during his term of office. Judge Desmond, in a partial dissent, argued against the remission to Special Term on the grounds that petitioner, being neither a stockholder nor a director, has no rights at all to an inspection.

Book Value

The Court of Appeals entertained the problem of determining the correct book value of a corporation in *Aron v. Gillman*.¹¹ An agreement between the parties provided for a sale of shares of a jointly owned corporation by the first to die to the survivor "at the book value thereof." This was to be determined by the most recent audit of the books of the corporation, provided the audit be made not more than 60 days before the date of death. The items of dispute were an estimated inventory figure and a contingent reserve for taxes payable.

Judge Froessel, writing for the majority, held that the amount conceded by plaintiff to be the actual value of corporation's merchandise inventory on date of audit rather than the much smaller figure submitted to the accountant by the decedent president should be used to determine the book value of the stock. Also, the corporation's estimated income taxes for the period covered by the audit should have been deducted.

The courts of this state have never given an authoritative definition of the term "book value."¹² The principles have emerged, however, that book entries must be correct and complete and not made to defeat an outstanding claim, and that accepted accounting standards should be adhered to. It is regarded as good accounting practice for an auditor to take a physical sample of inventory figures supplied him, thus giving support to the majority result concerning the inventory.¹³ It is likewise sound accounting practice that each dollar of income should bear its proportionate share of the costs of the enterprise, including the tax burden, as it is earned throughout the years.¹⁴ Therefore, an interim audit made during the taxable year should include an estimate of the income taxes applicable to the period

11. 309 N. Y. 157, 128 N. E. 2d 284 (1955).

12. See, 7 WHITE, NEW YORK CORPORATIONS, § 7.26.

13. American Institute of Accountants, report bulletin, September 19, 1939.

14. *Commissioner of Internal Revenue v. Shock, Gusmer & Co.*, 137 F. 2d 750, (3rd Cir. 1943); *Allen v. Atlanta Stove Works*, 138 F. 2d 452, (5th Cir. 1943).