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Corporate Legislation

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no more than ten persons comprise the organization all having the same responsibility and signing the same agreement, or comprise the incorporators signing the articles of incorporation.⁵³

Washington: No longer exempt are transactions whereby interests in oil and gas leases on property are acquired by partnership or joint venture.⁵⁴

MISCELLANY

Although in 1961 many miscellaneous amendments were passed which defy any neat categorization, there are two which merit reporting. In Illinois the sale of life insurance and mutual fund shares as a "package" may be a separate security and must be registered.⁵⁵ In Oklahoma, oil, gas, and mining interests are not securities according to the recent legislative pronouncement.⁵⁶

DANIEL J. JOHNEDES

CORPORATE LEGISLATION

On April 24, 1961, New York adopted a completely new corporation law¹ which will take effect April 1, 1963.² The new act, designated the Business Corporation Law, is essentially an integration and revision of existing New York statutes. However, the draftsmen, strongly influenced by the Model Business Corporation Act and various modern approaches adopted by other jurisdictions, added some significant innovations.

The scope of the following comment is limited to a presentation in outline form of the essential characteristics of this noteworthy legislation. For a more complete view of the new act it is strongly recommended that the reader study the text of the statute³ in conjunction with the Joint Committee Report.⁴

After April 1, 1963, business corporations will no longer come under the provisions of the New York General Corporation Law or of the New York Stock Corporation Law.⁵ Defining for the purposes of the statute, a corporation as a corporation for profit,⁶ the new law applies to every domestic or foreign corporation which is authorized or does business in New York,⁷ but it does not, however, apply to other types of corporations formed under other New York statutes.⁸

⁵³ Utah Code Ann. § 61-1-5 (1953).

⁵⁴ Wash. Rev. Code § 21.20.320 (1951).

⁵⁵ Blue Sky L. Rep. ¶ 16,791.

⁵⁶ Okla. Laws 1961, S.B. No. 10.

¹ N.Y. Session Laws 1961, ch. 855 [hereinafter cited by section].

² Section 1401.

³ *Supra* note 1.

⁴ New York Legislative document No. 12 (1961) [hereinafter cited as Document]. For a history of the Revision Committee see generally, Summary of Changes in New York Corporation Law 2-7 (Matthew Bender Co. 1961) [hereinafter cited as Summary].

⁵ Section 103 e.

⁶ Section 102 a(4).

⁷ Section 103 a.

⁸ Section 103 a. Excludes, therefore, corporations formed under the Banking

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In addition to the usual corporate purpose section authorizing a corporation to do any lawful business, the draftsmen, to obviate the necessity of amending the charter or of passing special enabling legislation, provided that in time of war or other national emergency, a corporation, after a request by competent governmental authority, may do any lawful business without regard to its stated purposes and powers.⁹ The certificate of incorporation must still state the purpose for which the corporation is formed.¹⁰ A corporation's powers are of course limited by the corporate purpose as these powers must be in furtherance of its purpose and are also subject to charter limitations.¹¹ The powers listed in the statute and which need not be enumerated in the charter¹² are gathered from existing New York law and generally correspond to what would otherwise be implied powers. Some of the existing powers are expanded and new powers are added. The power to guarantee has been broadened,¹³ and, subject to charter limitations, a corporation is now allowed to acquire the securities of another corporation even though the other corporation is engaged in an unrelated activity.¹⁴ Also, a corporation now has the express power to compensate its directors,¹⁵ and the directors are allowed to fix their own compensation unless provided otherwise by the by-laws or the certificate of incorporation.¹⁶

Any doubts as to the vitality, in New York, of the corporate benefit theory have been removed by allowing corporations to make charitable contributions "irrespective of corporate benefit."¹⁷ However, it is probable that common shareholder dividend privileges limit this rather broad authorization. A complete change in New York law is found in the allowance of a corporation to be a partner in business enterprises or ventures.¹⁸

While mostly codifying case law regarding the defense of ultra vires, the new law effects a substantial change by eliminating that defense to both parties in wholly executory contracts and brings New York into the camp of a small but growing minority of jurisdictions.¹⁹

The new Business Corporation Law changes existing law somewhat in expressly prohibiting names that "tend to confuse or to deceive" by being similar to or the same as an existing or reserved name.²⁰ Thus, the emphasis is put on conflict and not on deception as was formerly the case in

Law, the Railroad Law, the Insurance Law, the Transportation Law, the Cooperative Corporation Law. See Document, *op. cit. supra* note 4, at 11.

⁹ Section 201.

¹⁰ Section 402 a(2).

¹¹ Section 202.

¹² Section 402 b.

¹³ Section 202 a(7).

¹⁴ Section 202 a(6). Previously a corporation was limited so that it could acquire securities of another corporation only when authorized by the certificate of incorporation and the businesses were engaged in similar or connected activity or the two businesses could consolidate. See N.Y. Stock Corporation Law § 18.

¹⁵ Section 202 a(10).

¹⁶ Section 713 c. See Document, *op. cit. supra* note 4, at 49.

¹⁷ Section 202 a(12).

¹⁸ Section 202 a(15). See generally Henn, *Corporation* 282-83 (1961).

¹⁹ Section 203. See also Document, *op. cit. supra* note 4, at 17.

²⁰ Section 301 a(2).

New York.²¹ A corporation name may now be reserved for a period of sixty days with two possible extensions. This applies to a corporation that is to be formed and also to a corporation that intends to change its name.²²

To eliminate useless dummy incorporators the Business Corporation Act now allows one or more natural persons to act as incorporators.²³ Corporate existence still begins with the filing of the certificate of incorporation with the Department of State, but such filing is now conclusive evidence that all conditions precedent have been met, rather than presumptive evidence as formerly. This does not apply where proceedings are brought by the Attorney General.²⁴

It is in the area of corporate finance that the most significant changes have been made in New York law. It is urged that the reader refer to the act itself as limited space precludes a detailed analysis. The new law provides that subscriptions shall be irrevocable for three months unless all the subscribers consent otherwise.²⁵ Retained are the provisions that certificates for shares may not be issued until completely paid for, although stockholders may approve a plan for the issue of certificates for shares, partial payment for which has been made under an installment purchase plan for officers, directors and employees.²⁶ Shareholder approval is still required to authorize stock options for directors, officers and employees.²⁷ However, the new act departs from prior New York law by providing that the appraisal rights of dissenting shareholders, having preemptive rights in shares subject to such an option plan, will be lost if the majority of the holders of the shares with those preemptive rights approve the option plan.²⁸

When no par value stock is issued the board of directors may allocate a portion of the consideration, in excess of any liquidation preference, to capital surplus.²⁹ Dividends may still be paid from any surplus except when the corporation is currently insolvent or would thereby be made insolvent.³⁰ However, when a corporation does pay a dividend from other than earned surplus, a disclosure of its effect on stated capital, capital surplus and earned surplus must accompany the dividend in the form of a notice.³¹ Special exceptions are made in the case of a wasting asset corporation.³²

If provided for in the certificate of incorporation, a corporation may issue redeemable common shares if, at the time of the issuance, the corporation has an outstanding class of common shares that is not subject to

²¹ Document, *op. cit.* supra note 4, at 21.

²² Section 303.

²³ Section 401. Formerly there had to be three incorporators who were residents, citizens and subscribers. See Document, *op. cit.* supra note 4, at 24.

²⁴ Section 403. See also Document, *op. cit.* supra note 4, at 25, and Henn, *op. cit.* supra note 18, at § 141, n.7.

²⁵ Section 503 a. See generally Lattin, *Corporations*, ch. 3, § 11 (1959).

²⁶ Sections 504 h, 505 e.

²⁷ Section 505 e.

²⁸ Section 505 d. Document, *op. cit.* supra note 4, at 27.

²⁹ Section 506.

³⁰ Section 510 a. The express inclusion of this insolvency test is added to clear up any doubt that might now exist in New York. Document, *op. cit.* supra note 4, at 29. See generally Henn, *op. cit.* supra note 18, at § 320.

³¹ Section 510 a(2).

³² Section 510 a(1).

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redemption.³³ Only an open end investment company may issue shares redeemable at the option of the shareholder.³⁴ New in New York law, but found in California, Delaware, and Maryland is the provision that a corporation may in its certificate of incorporation give bondholders the right to inspect corporate books, to vote, and "any other right shareholders may have."³⁵

The holding of an annual meeting, which may take place out of state, is now expressly required.³⁶ Because of non-use, the "closing of the books" method of fixing a record date has been omitted, allowing directors to fix the record date which may be up to fifty days prior to a meeting.³⁷ The majority quorum requirement, which can be lowered by the certificate of incorporation or by a by-law or increased by the certificate of incorporation, is retained.³⁸ However, it is now provided that once a quorum is present, withdrawal of any shareholder does not break the quorum.³⁹

The new act gives statutory validity to shareholder voting agreements.⁴⁰ In addition the law allows what would otherwise be improper restrictions on the management functions of directors.⁴¹ Such a restriction must be contained in the certificate of incorporation or an amendment thereto, and must be approved either by all the incorporators or by all the shareholders whether or not such shareholders have voting powers.⁴² While such a provision is in force the law imposes on shareholders the same liability for managerial acts and omissions that is imposed on directors.⁴³ Inasmuch as this type of restriction is limited to corporations whose securities are not traded on a national securities exchange or regularly over the counter, its use would be limited to close corporations.⁴⁴

To avoid any possible existing confusion the new law defines a derivative action as one that "may be brought in the right of a domestic or foreign corporation to procure a judgement in its favor. . . ."⁴⁵

Qualifications of directors are left to be provided for by the by-laws or the certificate of incorporation.⁴⁶ Citizenship, state residence and share-

³³ Section 512 a(6).

³⁴ Section 512 b.

³⁵ Section 518.

³⁶ Section 602 b.

³⁷ Section 604.

³⁸ Section 608 a, b.

³⁹ Section 608 c.

⁴⁰ Section 620 a.

⁴¹ Section 620 b. See Summary, *op. cit. supra* note 4, at 24-5; Document, *op. cit. supra* note 4, at 40. This provision greatly expands *Clark v. Dodge*, 269 N.Y. 410, 199 N.E. 641 (1937): "If the enforcement of a particular contract damages nobody—not even in any perceptible degree, the public—one sees no reason for holding it illegal even though it *impinges slightly* upon the broad provisions of section 27." (Emphasis added.) *Id.* at 415, 199 N.E. at 642.

⁴² Section 620 b(1).

⁴³ Section 620 e.

⁴⁴ Section 620 c.

⁴⁵ Section 626 a. This provision removes the confusion introduced into New York by *Gordon v. Elliman*, 306 N.Y. 456, 119 N.E.2d 331 (1954), which held in part that an action to compel payment of dividends was a derivative suit for some purposes.

⁴⁶ Section 701.

holder status requirements have not been included.⁴⁷ With the minimum number of directors set at three, increases and decreases in the number can be made by the board or by the stockholders under by-laws adopted by the shareholders.⁴⁸ Shareholders have the exclusive right to remove directors without cause if so provided by the certificate of incorporation, and have the right to fill a vacancy thus created in the absence of a contrary certificate of incorporation or by-law provision.⁴⁹ Shareholder power to remove directors without cause is limited in those corporations which have cumulative voting provisions and in which a director or directors are elected by a certain class of shares.⁵⁰ The board of directors may fill a directorship vacancy unless it results from a removal without cause, or the certificate of incorporation or by-laws reserve that right to the shareholders.⁵¹

Great expansion of the power of executive committees is incorporated into the new law, giving to such a committee all the powers of the board. The committee's powers of course may be limited by restrictions in the by-laws, certificate of incorporation, or board resolution. An executive committee may not amend, repeal, or adopt by-laws, nor may it fill directorship vacancies or fix directors' salaries. Such a committee may not submit any action to the shareholders for their approval.⁵² This ability to delegate policy making power to an executive committee will be of great importance in flexible corporate management.⁵³

Regarding contracts and other transactions of interested directors the new act provides needed clarification and guidance. A corporation's contract in which one of its directors has an interest is not void or voidable even if such a director be present when the contract is approved or his votes are counted in approving the contract. The fact of his interest must be known or disclosed to the board and votes sufficient for approval without counting the vote of the interested director must be obtained. However, such a director may be counted to establish a quorum.⁵⁴ The prohibition formerly found in Stock Corporation Law, section 59, which forbade loans to directors and other specified classes who were also shareholders, has been removed.⁵⁵

Joining with an increasing number of states,⁵⁶ New York gives shareholders the right to elect all or specified officers of the corporation, if so provided in the certificate of incorporation.⁵⁷ A "shareholders'" officer may be removed with or without cause only by the shareholders.⁵⁸

Feeling a need for statutory finality, the revisers have included a

⁴⁷ See Document, *op. cit. supra* note 4, at 45.

⁴⁸ Section 702 a, b.

⁴⁹ Sections 705, 706.

⁵⁰ Section 706 c.

⁵¹ Section 705.

⁵² Section 712. See Document, *op. cit. supra* note 4, at 48. See generally Henn, *op. cit. supra* note 18, at § 213, nn. 2, 3.

⁵³ *Ibid.*

⁵⁴ Section 713.

⁵⁵ Section 714.

⁵⁶ See Henn, *op. cit. supra* note 18, at § 211.

⁵⁷ Section 715.

⁵⁸ Section 716 a.

standard by which the performance of the directors and officers must be assessed: "Directors and officers shall discharge the duties of their respective positions in good faith and with that degree of diligence, care and skill which ordinarily prudent men would exercise under similar circumstances in like positions."⁵⁹ Joint and several liability, with provision for contribution, is imposed on directors who vote or concur in declaration of dividends on distribution of assets and loans contrary to provisions of the law. The liability is to the corporation for the benefit of creditors and shareholders.⁶⁰ Presumed concurrence with the right of dissent is imposed on those directors who were not present and those who were present but did not vote.⁶¹ This section must be read and interpreted with section 717 defining the director's duty and allowing for his reliance on corporate and independent reports.⁶²

Indemnification of directors and officers in derivative and in non-derivative actions is set out with some new provisions.⁶³ It is specifically stated that the provisions of the law in regard to indemnification are exclusive and no contrary provision in by-laws, certificate, or resolution will be valid.⁶⁴ Indemnification is not authorized in settling pending or threatened derivative actions, while it may be allowed in settling non-derivative actions.⁶⁵ A court may direct indemnification in both derivative and non-derivative actions.⁶⁶ However, judicial direction or corporate authorization of indemnification is subject to the provision that in no case will indemnification be allowed when it would be inconsistent with certificate of incorporation or by-law provisions, or resolution of shareholders or directors in effect when the alleged cause of action accrued.⁶⁷

For the first time New York has statutorily adopted the accepted definition of consolidation and merger; merger being defined as two or more corporations becoming one which will be one of the constituent corporations and consolidation being defined as two or more corporations becoming a new corporation.⁶⁸ Express authorization for a merger between "non-parent-subsidiary" corporations is granted.⁶⁹ The procedure to be followed and information to be supplied in the plan approved by the directors, which must be submitted to the shareholders, has been greatly simplified.⁷⁰ In laying down guidelines for the sale and lease of assets the new act makes

⁵⁹ Section 717. See Document, which states: "The adoption of the standard prescribed by this section will allow the court to envisage the directors' duty of care as a relative concept depending on the kind of corporation involved, the particular circumstances and the corporate role of the directors." *Op. cit. supra* note 4, at 51. See generally Stevens, *Corporations* 708 (2d ed. 1949).

⁶⁰ Section 719.

⁶¹ Section 719 b.

⁶² *Supra* note 59.

⁶³ Sections 721-25.

⁶⁴ Section 721. See generally Henn, *op. cit. supra* note 18, at § 383, n. 3, for a lengthy analysis of the need for this provision in New York.

⁶⁵ Sections 722, 725.

⁶⁶ Section 724.

⁶⁷ Section 725 g(2).

⁶⁸ Section 901.

⁶⁹ Section 902.

⁷⁰ Section 902.

a change, by stating stockholders' approval is needed for "a sale, lease or other disposition of all or substantially all the assets of a corporation if not made in the usual or regular course of the business actually conducted by such corporation."⁷¹ Another important change is made by allowing the board of directors to authorize a mortgage or a pledge of all the corporation's assets, without shareholder approval, unless the certificate of incorporation contains contrary provisions.⁷²

Voluntary dissolution may still be effected by a vote of the holders of two thirds of all the shares entitled to vote.⁷³ Dissolution, however, will take place on the filing of the certificate of dissolution.⁷⁴ A change is made by providing that, at any time after dissolution, the corporation may give notice requiring all creditors and claimants to present claims within six months from the first publication of the notice.⁷⁵ Added under the new law is the provision that the corporation itself may petition the court to continue the liquidation under its supervision.⁷⁶

Proceedings by the Attorney General for judicial dissolution have been simplified and modernized.⁷⁷ Shareholders may petition for dissolution on approval of a resolution by majority vote (or a greater proportion if so provided in the certificate of incorporation) stating that dissolution would be beneficial or that the assets are insufficient to meet liabilities. A meeting to vote on such a resolution may be called by ten percent of the shares entitled to vote on such a question.⁷⁸ When there is a deadlock either between the shareholders or the directors, one half of the shareholders may petition for dissolution or, one shareholder may petition if two consecutive annual meetings have passed without election of directors.⁷⁹ Validity is also given to a certificate provision that any shareholder at will or on the happening of some stated event may enforce dissolution.⁸⁰

A foreign corporation can do any business in New York it is authorized to do in its own jurisdiction and such business as may be done by any domestic corporation.⁸¹ An authorized foreign corporation is limited to exercise only those powers which a similarly engaged domestic corporation can exercise, and it is further limited to exercise only those powers it can exercise in its own jurisdiction.⁸² A foreign corporation may now hold real property in New York without the former restriction of reciprocity.⁸³

⁷¹ Section 909. In the present law there is no express provision for a non-parent-sub subsidiary merger. Document, op. cit. supra note 59, at 59.

⁷² Section 911.

⁷³ Section 1001.

⁷⁴ Section 1003.

⁷⁵ Section 1006. Previously, notice was allowed to be given at any time after three years from the filing of the certificate. See Document, op. cit. supra note 59, at 65.

⁷⁶ Section 1007.

⁷⁷ Section 1101.

⁷⁸ Section 1103.

⁷⁹ Section 1104. Note that § 1112 apparently overrules *In re Radom & Neirdoff, Inc.*, 307 N.Y. 1, 119 N.E.2d 563 (1954), by providing that in a deadlock situation the fact that the corporation has or could make a profit will not be a basis for denying dissolution.

⁸⁰ Section 1105.

⁸¹ Section 1301.

⁸² Section 1306.

⁸³ Section 1307.

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A foreign corporation doing business without authority in New York may not sue in the state until it obtains authorization and pays all back taxes and fees. Contract rights and ability to be sued and power to defend are not impaired.⁸⁴

The new act makes provision for a new "type" of corporation—the Domiciled Foreign Corporation.⁸⁵ A domiciled foreign corporation is an authorized corporation doing business in the state and which has two thirds of all its outstanding shares with or without voting rights or two thirds of all outstanding shares with voting rights owned either beneficially or of record by New York residents, or two thirds of its business income or its investment income allocable to New York for franchise tax purposes.⁸⁶ The new law imposes on the directors of such a corporation the liability imposed on the officers and directors of domestic corporations.⁸⁷ Specified disclosure requirements applicable to domestic corporations are also imposed on the domestic foreign corporations with the same liability for failing to comply in good faith.⁸⁸ In addition, the domestic foreign corporation must also comply with indemnification provisions of the new act.⁸⁹

Both domestic and authorized foreign corporations may designate a registered agent on whom process may be served in addition to the Secretary of State.⁹⁰

Other jurisdictions have not been inactive and have provided some new noteworthy legislation. A realization of the needs of close corporations is reflected in the new laws of five states.

Delaware recognized this need in allowing that the minimum number of directors should be three "except in cases where all the shares are owned beneficially or of record by either one or two shareholders, the number of directors may be *either one or two* but not less than the number of shareholders."⁹¹ Iowa will also now allow a corporation to have one director.⁹²

Along the same line three states made statutory provisions allowing the board of directors to act informally. Illinois now authorizes informal action if consent is given in a writing setting forth the action taken.⁹³ In Ohio, directors and shareholders may act without a formal meeting, unless prohibited by the articles of incorporation, if accompanied with an affirmative written vote signed by all the shareholders entitled to vote or all the directors.⁹⁴ California allows the informal meeting if the articles of incorporation so provide and with the written consent of all the directors.⁹⁵

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⁸⁴ Section 1312.

⁸⁵ See generally Latty, Pseudo Foreign Corporations, 65 Yale L.J. 137 (1955); Conroy, Developments in Corporate Law, 16 Bus. Law. 799, 817 (1961).

⁸⁶ Section 1317.

⁸⁷ Section 1318. See supra note 52, and § 720 (not noted herein).

⁸⁸ Section 1319.

⁸⁹ Section 1320. See supra note 55.

⁹⁰ Section 305 a.

⁹¹ Del. Code Ann. tit. 8, § 141.

⁹² Iowa Code § 321.34 (1958).

⁹³ Ill. Rev. Stat. ch. 32, § 147.1 (1959).

⁹⁴ Ohio Rev. Code Ann. § 1701.54 (Baldwin 1958).

⁹⁵ Cal. Corp. Code § 814.5.