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Robert S. Stevens

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## NEW YORK BUSINESS CORPORATION LAW OF 1961

*Robert S. Stevens*†

The Business Corporation Law passed by the Legislature at the 1961 session and approved by the Governor is the first major revision of New York law relating to business corporations in over thirty years. It consolidates into one law, simplifies, and modernizes most of the provisions in the General Corporation Law and the Stock Corporation Law affecting business corporations, omits some of these, and adds some new ones. In the first report of the Joint Legislative Committee to Study Revision of Corporation Laws, in 1957, it was stated that the Committee's objective was to prepare a Business Corporation Law which will represent the proper balance of the interests of shareholders, management, employees, and the overriding public interest. During the four years of study this has been the constant objective of the Committee.

The new law will apply not only to business corporations to be formed in New York, but also to existing domestic business corporations and to foreign corporations doing business in the state. Upon the effective date of the new law, which is postponed to April 1, 1963, the General and the Stock Corporation Laws become inapplicable to all business corporations except those governed by the Banking, Insurance, Railroad, Transportation, and Cooperative Corporations Laws. Because those laws are in part dependent upon the Stock Corporation Law, the latter cannot be entirely repealed until those laws are made self-sufficient or amended so as to be interrelated with the Business Corporation Law rather than the Stock and General Corporation Laws. To attempt to secure such an adjustment of these special laws is an immediate objective of the Joint Legislative Committee.

As a preface to a consideration of the new law, it will be illuminating to indicate the procedure adopted by the Committee and to emphasize the invaluable collaboration of groups and of individuals representing varying interests in the project.

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† See Contributors' Section, Masthead, p. 248, for biographical data.

The Joint Legislative Committee was created by resolution of the Senate and Assembly in March, 1956. Soon thereafter, as a part of the adopted plan of operation, six advisory subcommittees were appointed. Among these was a Committee on Relation with Members of the Bar which consisted of sixteen attorneys practicing in different parts of the state in the field of corporate law. Liaison was early established by this committee with the Corporation Law Committee of the State Bar Association and with the Committee on Corporate Law of the Bar Association of the City of New York.

An Advisory Subcommittee on Labor and Industry included representatives of the New York State AFL-CIO, the International Ladies' Garment Workers, Associated Industries of New York State, Inc., New York Chamber of Commerce, Empire State Chamber of Commerce, Commerce and Industry Association of New York, Inc., American Institute of Certified Public Accountants, New York State Society of Public Accountants, American Society of Corporate Secretaries, Inc., Corporate Transfer Agents Association, General Electric Company, United States Corporation Company, and Prentice-Hall, Inc.

An Advisory Subcommittee on Relations with Other Revision Committees consisted of members of the American Bar Association Committee responsible for the drafting of the Model Business Corporation Act and representatives of the agencies guiding the revision efforts in eleven other states.

The Subcommittee on Relations with Other State Agencies kept in contact with the Department of State, the Department of Law, the State Tax Commission, the Banking Department, the Insurance Department, the Public Service Commission, and the Joint Legislative Committee to Revise the Banking Law and the Joint Legislative Committee on Insurance Rates and Regulations.

In the first years of its existence, the Committee decided that in its efforts toward the preparation of a Business Corporation Law, research studies of the many topics should precede actual drafting. A standard form for research reports was prescribed and included:

- (a) A statement of the problem.
- (b) Recommendation.
- (c) A comparative presentation setting forth the text of the comparable provisions in the Model Act and in the statutes of California, Delaware, District of Columbia, Maryland, Massachusetts, North Carolina, Ohio, Pennsylvania, Texas and Virginia.
- (d) An analysis of these provisions.
- (e) Reviser's Notes explaining the recommendation.

- (f) An Appendix containing citation of decisions, other statutes and text or law review material bearing upon the problem.

The total output was 142 of these research reports. Copies of each of these, or summaries of each, were sent to the members of the subcommittees and advisory groups. From them 1350 typed comments were returned. These views from persons representing varying interests in corporation law were used in reappraising the original recommendations and in the preparation of final research reports. The latter were given the same wide distribution. Questions of policy were under continuous study and decision by the Joint Committee.

Thus was obtained, before drafting was undertaken, what was considered should be the substantive provisions of the new law. An initial Working Draft was followed by a Tentative Staff Draft, each of which was the subject of conferences in New York City between the Committee and its staff and the members of the advisory groups. This was the method of crystalizing the content and form of the bill introduced in the Legislature in March 1960, intended as a Study Bill to be the subject of public hearings and perfection before the next legislative session. From the spring to the fall of 1960, five regional public hearings were held in addition to further conferences with representatives of bar association committees. A revised bill was pre-filed in December and in the ensuing session of the Legislature, a public hearing on this bill was held in the Senate Chamber. At this hearing, a number of objections and improvements were put forth by bar committees and others. Thereafter, the Committee, its staff, and the State and City Bar Committees cooperated closely and intensively in preparing the amended bill which was filed on March 6 and passed unanimously on March 22.

Since this act will not become effective until April 1, 1963, there will be time to discover and correct any of its imperfections and for existing corporations to adjust themselves to the provisions that will become applicable to them.

In the following presentation, the intention will be to emphasize the changes that the Business Corporation Law will make in the present law. If some matters of corporation law are not mentioned, it may be presumed that this is because no change is made. For brevity, BCL, GCL, and SCL will be used to designate the Business Corporation Law, General Corporation Law and Stock Corporation Law, respectively. The Model Act is the Model Business Corporation Act prepared by the Committee on Corporate Laws of the American Bar Association as revised up to August, 1959.

## PURPOSES AND POWERS

Corporate purposes and powers are set forth in Article 2. A corporation may be formed under this chapter for any lawful business purpose or purposes except to do in this state any business for which formation is permitted under any other statute of this state unless such statute permits formation under this chapter. By virtue of the definition in section 102(4), "corporation" as here used means a corporation formed for profit. A provision, new to New York, patterned on the Model Act and found in thirteen other states and the District of Columbia, would, in time of war or other national emergency, expand the purposes of a corporation, beyond those stated in its certificate, to do any lawful business in aid thereof at the request of any competent governmental authority.

The general powers enumerated in section 202 include those conferred by present law, but sometimes in broadened language. Added, are the power to pay pensions and establish profit-sharing, share bonus, share purchase, share option, savings, thrift and other retirement, incentive and benefit plans; to be a promoter, partner, or manager of other business enterprises or, when permitted in other jurisdictions, to be an incorporator, and to acquire the securities of others whether the issuer is engaged in a similar or different business or other activities, even though governmental. All of these powers are subject to the qualification that they are to be exercised in furtherance of the corporate business and that they are subject to any limitations in this chapter, any other statute of the state, or the certificate of incorporation. However, the power is given, irrespective of corporate benefit, to make donations for the public welfare or for charitable or educational purposes, and, under section 908, to give a guarantee, although not in furtherance of its corporate purposes, when that is authorized by vote of the holders of two-thirds of the shares. The certificate must state the purposes for which the corporation is formed, but need not set forth any of these general powers, although, as indicated, it may be found desirable to qualify or negate some of them.

Section 203 codifies the ultra vires doctrine by providing that an act of a corporation, otherwise lawful, is not invalid because of its lack of capacity or power to do it, but a shareholder may enjoin an ultra vires act, an officer or director may be liable to the corporation for loss or damage due to his unauthorized act, and the Attorney-general may bring an action or special proceeding to dissolve the corporation or to enjoin it from ultra vires action.

## INCORPORATION

Section 303 goes beyond the present law in permitting an available corporate name to be reserved in anticipation of incorporation. The

reservation will be for sixty days and may be renewed for two periods of not more than sixty days. In order to identify the person making the reservation, the certificate of reservation issued by the department of state must accompany the certificate of incorporation.

Section 401 provides that one or more natural persons of the age of twenty-one years or over may act as incorporators of a corporation to be formed under this chapter. Iowa, Kentucky, Michigan, and Wisconsin have like provisions for one or more incorporators. This section follows the Model Act and the statutes of a great majority of states in eliminating the citizenship and residence qualifications for incorporators, and it does not require that incorporators shall be subscribers for shares. In addition, it does not require the first directors to be named in the certificate of incorporation. These provisions remove the necessity of having to find and use persons who will temporarily fulfill the requirements as to number, citizenship, residence, and subscribers for shares and act as directors until the organization meeting is held after incorporation. It follows that it is also unnecessary to have the certificate of incorporation contain statements indicating compliance with those requirements.

The certificate of incorporation is required to be signed and acknowledged by each incorporator and, because signatures are sometimes undecipherable, the name and address of each must be stated opposite or beneath the signature.<sup>1</sup>

It is still required that the certificate shall designate the Secretary of State as agent upon whom process against the corporation may be served, but the option is also given to designate for that purpose a registered agent who may be a resident, a domestic corporation, or a foreign corporation authorized to do business in the state.<sup>2</sup>

Throughout the act, the term "stated capital" is used in place of "capital" or "capital stock."<sup>3</sup> The certificate is required to state:

The aggregate number of shares which the corporation shall have the authority to issue; if such shares are to consist of one class only, the par value of the shares or a statement that the shares are without par value; or, if the shares are to be divided into classes, the number of shares of each class, and the par value of the shares of each class or a statement that such shares are without par value.

It will no longer be necessary to include one of the alternative statements required by section 12 of the SCL. If preferred shares are to be issued in series, the certificate must give the designation of each series and state the variations in "the relative rights, preferences and limita-

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<sup>1</sup> N.Y. Bus. Corp. Law § 402(a). Hereinafter, unless cited to the contrary, all footnoted sections will pertain to the Business Corporation Law.

<sup>2</sup> § 305(a).

<sup>3</sup> §§ 102(12) and 506.

tions as between series," if these are to be fixed by the certificate, and a statement of any authority vested in the board to designate the series and fix the variations. The quoted language is substituted for "preferences, privileges and voting powers of the shares of each series of such class, and the restrictions or qualifications thereof," as used in sections 5 and 11 of the SCL. It should be noted that section 502(b) eliminates the present restriction that "the shares of all series of the same class having voting power shall not have more than one vote each."

Concentrated in one section are the general requirements as to the form, signing, filing, and the effectiveness of any certificate or other instrument relating to a domestic or foreign corporation which is delivered to the Department of State for filing under this chapter.<sup>4</sup> In addition, it is provided that when the certificate of incorporation has been filed by the Department of State, such certificate shall be conclusive evidence that all conditions precedent have been complied with and that the corporation has been formed, except in an action or special proceeding brought by the Attorney-general to annul or dissolve the corporation or to enjoin acting as a corporation without being duly incorporated.<sup>5</sup>

It is required that, after incorporation, an organization meeting shall be held for the adoption of by-laws, the election of directors, and the transaction of such other business as may come before the meeting. It is made clear that any action that may be taken at an organization meeting may be taken without a meeting if each incorporator or his attorney-in-fact signs an instrument setting forth the action so taken.<sup>6</sup>

#### CORPORATE FINANCE

##### (a) *Shares, Share Certificates, Fractions of Share or Scrip*

A corporation will have power to issue the number and classes of shares stated in its certificate of incorporation. Shares which are entitled to a preference as to dividends or assets may not be designated as common shares and shares which are not entitled to such preferences may not be designated as preferred shares. Subject to the designations, relative rights, preferences, and limitations applicable to separate series, each share shall be equal to every other share of the same class.<sup>7</sup>

Any class of preferred shares may be divided into series if the certificate so provides and the relative rights, preferences, and limitations of

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<sup>4</sup> § 104.

<sup>5</sup> § 403.

<sup>6</sup> § 404.

<sup>7</sup> § 501. Dean de Capridles, draftsman of the financial provisions in Article 5 and Edward McAniff have discussed these provisions in 36 N.Y.U.L. Rev. pp. 1239-73 (1961). See also Note on article 5 in 13 Syracuse L. Rev. 93 (1961).

any series may be fixed in the certificate or fixed by the board if so authorized in the certificate. Before the issue of any shares of a series established by the board of directors, a certificate of amendment, authorized by the board and stating the number, designations, relative rights, preferences, and limitations of the shares as so fixed, must be delivered to the Department of State as provided in section 805.<sup>8</sup>

If a corporation is authorized to issue shares of more than one class or to issue shares of a class in series, permission is given to state on the face or back of share certificates that the corporation will furnish any shareholder, upon request and without charge, a full statement of the designations, relative rights, preferences, and limitations of the shares of each class or series, in lieu of the alternative requirement that these facts shall be set forth in detail on the face or back of the certificate.<sup>9</sup>

A corporation is given authority, at its option, to issue fractions of a share entitling the holder to voting rights, dividends, and liquidating distributions in proportion to his fractional holdings or to pay in cash the fair value of fractional interests. As an alternative, a corporation may issue scrip in registered or bearer form and subject to the condition that it will become void if not exchanged for certificates for full shares before a specified time or that the shares for which the scrip is exchangeable may be sold and the proceeds remitted to the holder of the scrip. A corporation may provide reasonable opportunity to persons entitled to fractions or scrip to sell the same or buy additional fractions or scrip.<sup>10</sup>

In view of these new provisions, section 504(h) changes the law as contained in section 74 of the SCL by providing that certificates for shares may not be issued until the full amount of the consideration therefore has been paid, except under section 505(e) when shares are issued for payment in installments under a plan for the issue of rights or options to directors, officers, and employees.

*(b) Subscriptions for Shares*

A subscription, whether made before or after incorporation, is not enforceable unless in writing and signed by the subscriber, and, unless otherwise provided in the subscription agreement, a subscription for shares of a corporation to be formed is irrevocable, except with the consent of all other subscribers, for a period of three months from its date. Paralleling section 68 of SCL, subscriptions are to be paid as determined by the board of directors or, if there be a receiver, by the receiver. There are slight changes as to forfeiture for nonpayment of

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<sup>8</sup> § 502.

<sup>9</sup> § 508(b).

<sup>10</sup> § 509.

installments. The by-laws may provide other penalties than forfeiture. Shares forfeited and not sold are to be restored to the status of authorized but unissued shares and the forfeited payments are to be transferred to capital surplus. If forfeited shares are resold, the excess over the amount due and unpaid must be paid to the delinquent subscriber.<sup>11</sup>

(c) *Consideration and Payment for Shares*

Portions of sections 11 and 69 of the SCL have been combined and reworded.<sup>12</sup> Neither obligations of the subscriber or purchaser for future payments nor future services shall constitute payment for shares, except that shares may be issued for services rendered in the formation or reorganization of a corporation. Omitted is the requirement that shares issued for property shall be so reported. The consideration to be received for shares without par value is to be fixed from time to time by the board of directors unless the certificate reserves this right to the shareholders. Treasury shares may be disposed of for such consideration as is fixed by the board. If authorized but unissued shares are distributed to shareholders, that part of the surplus concurrently transferred to stated capital is the consideration for the issue of such shares. If bonds or shares are converted into or exchanged for shares, the consideration for the new shares so issued is the sum of (1) either the principal of and the accrued interest on the bonds or the stated capital then represented by the shares so converted or exchanged, plus (2) any additional consideration paid for the new shares, plus (3) any surplus transferred to stated capital in respect of the new shares.

Stated capital is defined to include the sum of (A) the par value of all issued shares with par value, (B) the amount of consideration received for all issued shares without par value, except such part of the consideration therefor as may have been allocated to capital surplus by the board of directors, and (C) such amounts not included in clauses (A) and (B) as have been transferred to stated capital, whether upon the distribution of shares or otherwise, minus all reductions from such sums as have been effected in a manner permitted by law.<sup>13</sup> The board of directors is given authority, within a period of sixty days after the issue of shares without par value, to allocate to capital surplus a portion, but not all, of the consideration received therefor, except, that if the shares have a preference in the assets upon liquidation, such an allocation may be made only from the excess of the consideration

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<sup>11</sup> § 503.

<sup>12</sup> § 504.

<sup>13</sup> §§ 102(12) and 506.

received over the amount of the preference. There is thus effected a partial change in the present law because under section 12 of SCL, a capital surplus would result only if the shares without par value were given a stated value, and if they were not given a stated value, all of the consideration received for such shares was required to be credited to stated capital. If stated capital is increased by transfers from surplus, the board of directors is authorized to direct that the amount so transferred shall be stated capital in respect of any designated class or series of shares. This authority now exists by implication from the wording of sections 27(3) and 29(2) of the SCL.

It is provided that when the consideration for shares has been paid in full, the subscriber shall be entitled to all the rights and privileges of a holder of such shares and to a certificate representing his shares, and such shares shall be fully paid and nonassessable.<sup>14</sup> It is further provided that the reasonable charges and expenses of formation or reorganization of a corporation and the reasonable expenses of and compensation for the sale or underwriting of its shares may be paid or allowed by the corporation out of the consideration received by it for its shares without thereby impairing the fully paid and nonassessable status of such shares.<sup>15</sup> This latter provision goes beyond the corresponding portion of section 69 of the SCL which permits such payment or allowance only in connection with the sale or underwriting of shares.

#### *(d) Rights and Options to Purchase Shares*

Section 505 combines, with some changes, section 14 of the SCL—Issue of shares to employees—and the portion of section 69 relating to other options to purchase shares. The new section retains the policy of section 14 requiring shareholder approval for granting share options to officers, directors, or employees and the policy of section 69 not requiring such approval for other share options. The express authority given the corporation by section 14 to establish a fund in which employees purchasing shares may participate has been omitted as falling within the range of managerial authority, and therefore, unnecessary. A more significant change is made with respect to the rights of dissenting shareholders. Under section 14, a dissenter who had a preemptive right to shares made subject to the employee option, might demand the appraised value of his shares. His so-called preemptive right was an empty one; the shares could be optioned in spite of it, and his remedy was to demand to be bought out. In view of this, two changes have been

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<sup>14</sup> § 504(i).

<sup>15</sup> § 507.

made in the new law. In the first place, in section 622(e), shares which are made subject to employee option under section 505(d) are expressly included with the other instances in which shares to be issued are not subject to preemptive rights unless otherwise provided in the certificate of incorporation. In the second place, section 505(d) omits the appraisal right of a dissenter and provides that if the certificate of incorporation gives a preemptive right to shares made subject to an employee option, then, in addition to the vote of the holders of a majority of all outstanding shares required for the approval of such a share option plan, approval must also be given by the vote or written consent of the holders of a majority of the shares entitled to exercise preemptive rights with respect to the optioned shares, and approval so given will operate to release the preemptive rights of the holders of all such shares. This provision follows generally the pattern of the statutes of California and Pennsylvania.

As previously indicated, an exception is made for the issue of certificates for shares to be paid for in installments under an employee option plan if the plan approved by the shareholders so provides, and the holders of such certificates, even though the shares have not been fully paid for, may have such voting and dividend rights and be subject to such limitations upon the transferability of the shares as the approved plan provides. However, if approval is given for the issue of options to individual directors, officers, or employees, but not under a general plan, the grantees of such options may not be given voting or dividend rights until the consideration for their shares has been fully paid.

*(e) Dividends and Other Distributions in Cash or Property*

The principle of section 58 of the SCL and section 664 of the Penal Law that dividends or other distributions in cash or property may be paid out of any kind of surplus is retained.<sup>16</sup> It adds, however, three new provisions. The first of these prohibits such payments or distributions when the corporation is or would thereby be made insolvent. "Insolvent" is defined in section 102(8) to mean being unable to pay debts as they become due in the usual course of the debtor's business.<sup>17</sup> The second is an exception, based upon the law of Delaware and other jurisdictions, permitting a wasting assets corporation to make such payments in excess of its surplus. The third requires that when any dividend is paid or other distribution is made, in whole or in part, from sources other than earned surplus, it shall be accompanied by a notice (A) disclosing the amounts by which such dividend or distribution affects stated capital,

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<sup>16</sup> § 510.

<sup>17</sup> § 102(8).

capital surplus, and earned surplus, or (B) if such amounts are not then determinable, disclosing the approximate effect upon stated capital, capital surplus, and earned surplus and stating that such amounts are not yet determinable. "Earned surplus" is defined as excluding unrealized appreciation of assets.<sup>18</sup>

(f) *Share Distributions and Reclassifications*

Authorized but unissued shares may be distributed to shareholders provided there be transferred from surplus to stated capital an amount at least equal to the aggregate par value of the shares so issued and having par value or, if the shares are without par value, an amount equal to the aggregate value of such shares as fixed by the board of directors. Shares of a class or series may be distributed only to the holders of the same class or series unless otherwise permitted by the certificate of incorporation or vote of the holders of a majority of the shares of the class or series to be distributed. It is also provided that a similar distribution may be made on treasury shares of the same class or series.<sup>19</sup>

If a reclassification of shares would increase the stated capital, there must be a transfer from surplus to stated capital of an amount equal to the increase. However, no transfer from surplus to stated capital is required upon a distribution of treasury shares or upon a split-up of outstanding shares into a lesser number when there is no change in the aggregate stated capital represented by them. If any transfer to stated capital is made, in whole or in part, from sources other than earned surplus, a provision parallel to that in section 510 requires disclosure of that fact to the shareholders.

Section 511 is based in large part upon section 40(c) of the Model Act, but there is one change in terminology. The Model Act speaks of declaring and paying dividends in shares and states that a split-up is not to be construed as a share dividend. Section 511 speaks of "share distributions" rather than "share dividends." This change was prompted by the decision of the Court of Appeals in *Matter of Payne (Bingham)*.<sup>20</sup> There, the question was whether shares distributed to a trustee under a trust created in 1915, which made no provision for "stock dividends," belonged to the income beneficiary or to the remainderman as principal. The distributed shares had been capitalized partly out of earned surplus and partly out of capital surplus which could not be identified as derived

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<sup>18</sup> § 102(6).

<sup>19</sup> § 511.

<sup>20</sup> 7 N.Y.2d 1, 163 N.E.2d 301, 194 N.Y.S.2d 465 (1959).

from earnings. It was held that the shares belonged to the life tenant only to the extent that they were capitalized out of earned surplus and to the remainderman to the extent that they were capitalized out of capital surplus. For the corporation, the legal problem is a different one, namely, when do shares distributed have to be capitalized out of surplus? No transfer from surplus to stated capital is required when shares are split up or split down and when the stated capital represented by the shares remains the same before and after the split. But when authorized but unissued shares are distributed as a "share dividend," they must be offset by a transfer from surplus to stated capital, and the statute permits this to be done from either earned or capital surplus, or both.

*(g) Redemption and Purchase of Its Own Shares*

The certificate of incorporation may authorize the issue of shares that are redeemable at the option of the corporation only. Common shares may not be made redeemable unless the corporation has outstanding a class of common shares that are not subject to redemption. An exception to both of these limitations is made applicable to open-end investment companies as defined in the federal Investment Company Act of 1940.<sup>21</sup> Such companies may provide for redeemable common shares and for shares that are redeemable at the option of the holder.<sup>22</sup>

A purchase or redemption may be made out of surplus, unless the corporation is insolvent or would thereby be made insolvent. With the same limitation as to insolvency, a purchase may be made out of stated capital for one of the following purposes: (1) eliminating fractions of shares, (2) collecting or compromising indebtedness to the corporation, (3) paying dissenting shareholders entitled to receive payment for their shares under this chapter, or (4) effecting a retirement of redeemable shares which would not reduce net assets below the stated capital remaining after giving effect to the cancellation of such shares. The first two of these are new. The last two are permitted by sections 21 and 28 of the SCL. The amount by which stated capital is reduced by the cancellation of reacquired shares must be disclosed to shareholders in the next financial statement or in the next dividend notice.<sup>23</sup>

*(h) Reduction of Stated Capital without Amendment*

Section 35(4) of the SCL includes reduction of capital either by amendment or by eliminating from capital any of the surplus previously

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<sup>21</sup> 54 Stat. 789 (1940), 15 U.S.C. §§ 80a-1—80a-52 (1958).

<sup>22</sup> § 512(b).

<sup>23</sup> §§ 513-15.

transferred thereto, and section 35 requires the filing of a certificate in both instances. Section 516 deals with two instances of reduction of stated capital not covered by cancellation of shares under section 515 or by amendment under Article 8, that is, (a) by eliminating amounts of surplus previously transferred to stated capital, and (b) by reducing without amendment, the amount of stated capital represented by issued shares without par value which are not to be cancelled. The latter is not expressly covered in the present New York statutes. Either method of reduction may be authorized by the board of directors, and disclosure to shareholders of the reduction by either method is substituted for the requirement of a certificate to be delivered to the Department of State for filing.

(i) *Special Provisions Relating to Surplus and Reserves*

A provision new to New York establishes principles to be applied when it is necessary for a corporation to determine the amount of its earned surplus. If a corporation formed before the effective date of this law has no accurate record of earned surplus, the board of directors may determine the amount thereof before the declaration of the first dividend after the effective date.<sup>24</sup> It thus supplements the portions of the sections which require disclosure of the effect which the payment of dividends or the distribution of shares may have upon stated capital, capital surplus, and earned surplus.

This section also permits a corporation to apply capital surplus to the elimination of any deficit in the earned surplus account if this is approved by vote of the shareholders. Disclosure of any such transfer has to be made to all shareholders.

(j) *Bonds and Mortgages*

The requirements of section 69 of the SCL as to the consideration for the issue of bonds are retained. A provision, new to New York but found in the statutes of California, Delaware and Maryland, permits a corporation to confer upon bondholders' voting rights and the right to inspect the books.<sup>25</sup>

Since the new law continues to provide that the business of a corporation shall be managed by its board of directors,<sup>26</sup> it would be the normal function of the board, rather than the shareholders, to determine the need for borrowing, the terms of the loan, and the type and terms of any security to be given. The new law has been drafted upon this normal as-

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<sup>24</sup> § 517.

<sup>25</sup> § 518.

<sup>26</sup> § 701.

sumption. First, it is provided that a corporation may issue bonds convertible into other bonds or shares within such period and upon such terms and conditions as are fixed by the board.<sup>27</sup> The requirement of section 16(1) of the SCL for shareholder approval of bonds convertible into shares has been omitted. Second, a significant change is made providing that the board of directors may authorize a mortgage or pledge of all or any part of the assets of the corporation and, unless the certificate of incorporation provides otherwise, no vote of shareholders shall be required to authorize such action by the board.<sup>28</sup>

(k) *Convertible Shares*

Combined in one section are some of the provisions of section 16 of the SCL, relating to convertible bonds, and of section 27 relating to convertible shares.<sup>29</sup> Whereas the authority of the board to issue convertible bonds exists unless restricted by the certificate of incorporation, the board's authority to issue convertible shares must, in the first instance, be conferred by the certificate of incorporation. Shares must be made convertible at the option of the holder only, and may not be made convertible into a class of shares which have rights or preferences prior or superior to those of the shares being converted. Converted shares must be cancelled and the effect, if any, of the conversion upon stated capital must be disclosed to shareholders.

(l) *Liability for Failure to Make Required Disclosure*

For a failure to comply in good faith with the requirements of disclosure to shareholders the corporation becomes liable for any resulting damage to any shareholder.<sup>30</sup>

#### SHAREHOLDERS

(a) *Shareholders' Meetings*

It is expressly required that a meeting of shareholders be held annually for the election of directors and the transaction of other business on a date fixed by or under the by-laws. Special meetings may be called by the board of directors and by such person or persons as may be so authorized by the certificate of incorporation or by-laws. Following the practice in three-fourths of the American jurisdictions, the statute provides that meetings may be held inside or outside the state as determined by or under the by-laws and the limitations imposed by section 45 of the SCL on holding meetings outside the state have been omitted.<sup>31</sup>

<sup>27</sup> § 519(c) and (d).

<sup>28</sup> § 911.

<sup>29</sup> § 519.

<sup>30</sup> § 520.

<sup>31</sup> § 602.

The provisions in sections 22 and 23 of the GCL, relating to the calling of special meetings for the election of directors, have been combined in one section and somewhat revised.<sup>32</sup> Such a meeting may be called by the board of directors or, if the board fails to do so, by the holders of ten per cent of the shares entitled to vote in the election of directors, rather than by a "member," as now provided.

In view of the fact that the holders of ten per cent of the shares may call such a meeting and that special meetings may be called as authorized by the certificate of incorporation or by-laws, section 52 of the SCL providing for meetings to be called by shareholders with judicial approval, has been eliminated.

The by-laws may authorize the board of directors to fix a record date for the purpose of determining the shareholders entitled to notice of and to vote at a meeting or for other purposes.<sup>33</sup> The alternative of closing the books for these purposes has been little used and has been omitted from this section. There are provisions, new to New York, for determining shareholders entitled to notice and to vote, to dividends, and so forth, when no record date has been fixed by the board.

It is provided that notice of a special meeting must state the purpose or purposes for which it is being called. If, at any meeting, which includes an annual meeting, action is proposed to be taken which would, if taken, entitle dissenting shareholders to receive payment for their shares, the notice of such a meeting must include a statement of that purpose and to that effect. Unless the by-laws provided otherwise, it will not be necessary to give notice of an adjourned meeting if the time and place of the adjourned meeting were announced at the meeting at which the adjournment was taken. However, if after the adjournment, the board fixes a new record date for the adjourned meeting, then notice of the adjourned meeting must be given to each shareholder entitled to notice on the new record date.<sup>34</sup>

Notice may, of course, be waived but there is the added provision that attendance at a meeting without protesting the lack of notice shall constitute a waiver of notice.<sup>35</sup>

The statutory quorum of the holders of a majority of the shares entitled to vote may be decreased by the certificate of incorporation or the by-laws, but not below one-third, or may be increased by the certificate of incorporation.<sup>36</sup> However, under these provisions the effect of section

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<sup>32</sup> § 603.

<sup>33</sup> § 604.

<sup>34</sup> § 605.

<sup>35</sup> § 606.

<sup>36</sup> §§ 608(b) and 616.

603(b) cannot be altered. It provides that at a special meeting called for the election of directors, "notwithstanding section 608 (Quorum of shareholders), the shareholders attending in person or by proxy, and entitled to vote in an election of directors shall constitute a quorum for the purpose of electing directors, but not for the transaction of any other business." This may be a change in the present law as judicially interpreted.<sup>37</sup> New provisions are to the effect that when a quorum is once present, it is not broken by the withdrawal of any shareholders, and that the shareholders present may adjourn a meeting despite the absence of a quorum.

The oath required of a shareholder by sections 20 and 24 of the GCL has been omitted from the new law. A more detailed statement as to the selection and duties of inspectors of election, based upon the statutes of California, Ohio, and Pennsylvania, has been substituted for that found in section 24 of the GCL and section 46 of the SCL.<sup>38</sup>

The substance of sections 47 and 48 of the SCL, as to the qualification of voters and voting by fiduciaries, has been continued,<sup>39</sup> but there have been added provisions: (a) Neither treasury shares nor shares of a parent corporation held by a majority-owned subsidiary may be voted at a meeting of the shareholders of the parent or counted in determining the number of its outstanding shares; and (b) shares that have been called for redemption may not be voted or counted as outstanding after an irrevocable deposit has been made of funds sufficient to cover the redemption price.

Section 615 gives blanket authorization for unanimous shareholder assent in writing without a meeting, in lieu of action by vote at a meeting, making it unnecessary to repeat this authorization in the several sections where it could be appropriately used, as is done in the present statutes.

The policy of section 9 of the SCL permitting the certificate of incorporation to contain a greater requirement as to quorum and vote of shareholders and directors, has been continued in section 616 (shareholders) and section 709 (directors), and such a provision may be added, changed, or struck out by vote of the holders of two-thirds of the shares or by such greater proportion as may be required by the certificate of incorporation.

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<sup>37</sup> In *M & E Luncheonette, Inc. v. Freilich*, — Misc. 2d —, 218 N.Y.S.2d 125 (Sup. Ct. Queens County 1961), the decision in *Matter of Faehndrich*, 2 N.Y.2d 468, 473-74, 141 N.E.2d 597, 600, 161 N.Y.S.2d 99, 104 (1957), was interpreted as indicating that under SCL § 55, the certificate or bylaws might alter the quorum provision of GCL § 23 providing that those attending a special election shall constitute a quorum.

<sup>38</sup> §§ 610 and 611.

<sup>39</sup> § 612. See discussion in *Dal-Tran Serv. Co. v. Fifth Ave. Coach Lines, Inc.*, — Misc. 2d —, 217 N.Y.S.2d 193 (Sup. Ct. N.Y. County), rev'd, — App. Div. 2d —, 220 N.Y.S.2d 549 (1st Dep't 1961).

One change in the law with respect to a judicial review of an election has been made.<sup>40</sup> The Court of Appeals has held that the alternatives given the court by section 25 of the GCL to "confirm the election or order a new election, as justice may require," are exclusive and not enlarged by the clause "as justice may require."<sup>41</sup> The court's power will be broadened by the new wording, "confirm the election, order a new election, or take such other action as justice may require."

(b) *Agreements as to Voting*

Two new provisions are contained in section 620. The first is not novel in effect because it codifies the substance of the dictum in *Manson v. Curtis*.<sup>42</sup> It provides that two or more shareholders may agree to exercise their voting rights as therein agreed, or as they may agree, or as determined in accordance with a procedure agreed upon by them. The possibility of an irrevocable proxy as a means of effecting the latter procedure is anticipated in section 609(f) and (g).

The second one of the new provisions is an innovation. It validates a provision in the certificate of incorporation "otherwise prohibited by law as improperly restrictive of the powers or discretion of the directors." It thus provides a means of legalizing the informal procedure and practices common in close corporations. Since, under this section, the statutory norm of corporate action through management by the board of directors may be varied, section 701 states that the business of a corporation shall be managed by its board of directors "subject to any provision in the certificate of incorporation authorized by paragraph (b) of section 620." Because authority for such informal action must have been unanimously approved by all incorporators or shareholders, must have the written consent of anyone who becomes a transferee of shares or holder of newly issued shares without knowledge of the provision, and is valid only so long as the shares of the corporation are not publicly traded in, the applicability of this provision is restricted to close corporations.<sup>43</sup>

(c) *Voting Trust Agreements*

Some slight changes as to voting trust agreements are made.<sup>44</sup> Such

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<sup>40</sup> § 619.

<sup>41</sup> *Matter of William Faehndrich, Inc.*, 2 N.Y.2d 468, 141 N.E.2d 597, 161 N.Y.S.2d 99 (1957).

<sup>42</sup> 223 N.Y. 313, 119 N.E. 559 (1918).

<sup>43</sup> To this extent, the section does not affect the decision in *Clark v. Dodge*, 269 N.Y. 410, 199 N.E. 641 (1936). But cf. *McQuade v. Stoneham*, 263 N.Y. 323, 189 N.E. 234 (1934) (agreement between less than all the shareholders); *Long Park, Inc. v. Trenton-New Brunswick Theatres Co.*, 297 N.Y. 174, 77 N.E.2d 633 (1948) (delegation of the power of management to one of the parties); and *Matter of Abbey (Meyerson)*, 274 App. Div. 389, 83 N.Y.S.2d 503 (1st Dep't 1948), aff'd mem. 299 N.Y. 557, 85 N.E.2d 789 (1949) (effect of agreement depriving board of its powers violated GCL § 27).

<sup>44</sup> § 621.

agreements are not required to be open so that all shareholders may transfer their shares to the same trustee. The right to inspect the trust agreement is given to trust certificate holders as well as to shareholders. It is provided that the agreement may be renewed by one or more holders of trust certificates at any time within six months before the expiration of the agreement and that such an extension shall not affect the rights or obligations of any persons who do not join in the renewal agreement.<sup>45</sup>

*(d) Procedure to Enforce Dissenter's Right to Payment for Shares*

Some changes are made as to a dissenter's right to receive payment for his shares.<sup>46</sup> First, he must file before or at the meeting written objection to the proposed action. After approval of the action by the shareholders, the corporation must notify dissenters that the action has been authorized, and then the dissenter, if he wishes, must file a written demand for payment. If agreement as to the fair value cannot be reached, the corporation is privileged to institute appraisal proceedings and, if it does not do so within a specified time, a dissenter may institute the proceeding. In any such proceeding, all dissenters who have not agreed with the corporation upon the value of their shares must be made parties.

Shareholders are required to dissent as to all the shares held by them and a nominee or fiduciary may not dissent on behalf of any one beneficiary as to less than all the shares held for that beneficiary.

Unless the corporation is insolvent, it may pay for dissenters' shares out of surplus or stated capital.<sup>47</sup> Stated capital must be reduced by the amount paid out of it, and the shares thus reacquired must be returned to the status of authorized but unissued shares.

The statement that after filing a demand for payment, the dissenter "shall cease to have any of the rights of a shareholder except the right to be paid for his shares" is qualified by expressly providing that this does not exclude his right to maintain an action for relief on the ground that the corporate action is illegal, irregular, or fraudulent. This is not a change in the present law,<sup>48</sup> but statutory clarification on this point is

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<sup>45</sup> Provisions comparable to the latter are found in Del. Code Ann. tit. 8, § 218 and Ohio Rev. Code § 1701.49 (Anderson Supp. 1961). A renewal agreement was upheld in *Mannheimer v. Keehn*, 41 N.Y.S.2d 542 (1943), *aff'd*, 268 App. Div. 813, 49 N.Y.S.2d 304 (4th Dep't 1944).

<sup>46</sup> § 623.

<sup>47</sup> § 513.

<sup>48</sup> *Eisenberg v. Central Zone Property Corp.*, 306 N.Y. 58, 115 N.E.2d 652 (1953). In *Beloff v. Consolidated Edison Co.*, 300 N.Y. 11, 87 N.E.2d 561 (1949), and *Anderson v. International Mineral & Chem. Corp.*, 295 N.Y. 343, 67 N.E.2d 573 (1946), the corporate action was found to be valid. *Matter of Drosnes*, 187 App. Div. 425, 175 N.Y. Supp. 628 (1st Dep't 1919), held that a dissenter could elect the right of appraisal and could not be compelled to sell.

desirable in view of what might otherwise be considered the definiteness of the language quoted.

(e) *Books and Records; Inspection*

Minutes of the proceedings of shareholders, directors, and executive committee have been added to books of account and record of shareholders as records which the corporation is required to keep. Recognizing the current use of punched cards, the statute has substituted "record of shareholders" for "stock book," and a corporation is permitted to keep records in any form capable of being converted into written form within a reasonable time. A shareholder, having the qualifications now required by section 10 of the SCL, is entitled to inspect the record of shareholders and the minutes of shareholders' meetings, and holders of voting trust certificates are given the same right. If a qualified shareholder is denied an inspection, he may apply for an order compelling an inspection and granting such further relief as may be proper. This judicial remedy is substituted for the fines collectible under section 10.<sup>49</sup>

(f) *Derivative Suits*

Some changes have been made regarding derivative suits, most of them for the purpose of clarifying existing law.<sup>50</sup> In contrast with the decision in *Gordon v. Elliman*,<sup>51</sup> a derivative suit is defined as one "to procure a judgment in favor of the corporation" as well as one brought in the right of the corporation. Whereas section 61 of the GCL is, by reference to section 60, restricted to such actions against directors or officers, section 625 applies to corporate actions against other persons as well as against directors and officers. A derivative action may be brought by holders of beneficial interests in shares as well as by shareholders and holders of voting trust certificates. It is made clear that the plaintiff must be a holder at the time the action is brought as well as at the time of the transaction of which he complains. The complaint must set forth the efforts of the plaintiff to secure the initiation of suit by the board of directors or the reasons for not making such effort. An action may not be discontinued, compromised, or settled without court approval, and anything received by the plaintiff by way of judgment, compromise, or settlement must be paid over to the corporation less any reasonable expenses and attorney's fees allowed by the court.<sup>52</sup> This latter provision,

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<sup>49</sup> § 624.

<sup>50</sup> § 626.

<sup>51</sup> 306 N.Y. 456, 119 N.E.2d 331 (1954).

<sup>52</sup> This codifies the principle established by *Clarke v. Greenberg*, 296 N.Y. 146, 71 N.E.2d 443, 169 A.L.R. 944 (1947).

however, does not apply to any judgment rendered for the benefit of injured shareholders only.

The corporation is entitled to request a bond to cover its own expenses in any derivative action but would require a bond to be given by the plaintiff to cover the individual defendant's expenses only when the corporation would be obligated to reimburse these.<sup>53</sup>

(g) *Liability of Subscribers and Shareholders*

A holder of or subscriber for shares is made liable to the corporation, rather than to its creditors, for the unpaid portion of his subscription.<sup>54</sup> The liability can thus be enforced by the corporation, a receiver, trustee in bankruptcy, or a judgment creditor.

That part of section 15 of the SCL which provides that a transfer of his interest by a holder or subscriber for shares while the corporation is insolvent or insolvency is imminent will not relieve him of any liability as a shareholder or subscriber is retained.

The liability of shareholders for wages due employees as imposed by section 71 of the SCL is modified.<sup>55</sup> Exempted from this liability are the shareholders of a corporation whose shares are traded on a national securities exchange or regularly traded in an over-the-counter market by one or more members of a national or affiliated securities association. As to other corporations, only the ten largest shareholders, as determined by their beneficial interest, are made liable, and a shareholder who has paid more than his pro rata share under this section is entitled to contribution for the excess from other shareholders liable under the section. The time within which an employee must notify a shareholder of his intention to hold him liable and to bring action has been increased from thirty to ninety days, and an unpaid employee is entitled to examine the record of shareholders.<sup>56</sup>

#### DIRECTORS AND OFFICERS

(a) *Qualifications and Number*

The only statutory qualification for directors is that they be at least twenty-one years of age but citizenship, residence, shareholder status, or other qualifications may be prescribed by the certificate of incorporation or by-laws.<sup>57</sup>

Section 702 provides that the number of directors, which may not be

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<sup>53</sup> § 627.

<sup>54</sup> § 628.

<sup>55</sup> § 630.

<sup>56</sup> § 624(b).

<sup>57</sup> § 701.

less than three, may be fixed, increased, or decreased by or under the by-laws, rather than by the certificate of incorporation. A decrease in number may not shorten the term of any incumbent director.

*(b) Election, Removal, and Classification*

As previously indicated, by-laws will be adopted and the first directors elected at the organization meeting, rather than named in the certificate of incorporation. Thereafter, directors are to be elected at annual meetings,<sup>58</sup> but vacancies resulting from an increase in number or for any other reason, except removal without cause, may be filled by the board of directors unless the certificate or the by-laws require that they be filled by vote of the shareholders. A vacancy occurring by removal without cause is to be filled by the shareholders unless the certificate or by-laws empower the directors to do this.<sup>59</sup>

Directors may be removed for cause by the shareholders or by the board of directors, if so authorized by the certificate or by-laws. If the certificate or by-laws so provide, directors may be removed without cause, and then only by the shareholders. In any case, cumulative and class voting rights are protected against impairment through the exercise of the power of removal. An action to procure the removal of a director for cause may be brought by the Attorney-general or by the holders of ten per cent of the shares. In such an action, the court may bar any director so removed from re-election for a period fixed by the court.<sup>60</sup>

The certificate of incorporation may provide that directors be divided into classes, all classes to be as nearly equal in number as possible, and no class to include less than three directors.<sup>61</sup>

*(c) Board of Directors Meetings*

Unless otherwise provided in the certificate of incorporation or by-laws, board of directors meetings may be held within or without the state. The time and place of meetings may be fixed by or under the by-laws or, if not so fixed, by the board. A majority of the entire board is the statutory norm for a quorum, and, except as otherwise provided in the act, the vote of a majority present at the time of voting, if a quorum is then present, will be the act of the board. However, the certificate or by-laws may fix a quorum at less than a majority but not less than one-third of the entire board, and, as under section 9 of the SCL,

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<sup>58</sup> § 703.

<sup>59</sup> § 705.

<sup>60</sup> § 706.

<sup>61</sup> § 704.

the certificate may require a greater proportion present for a quorum and a greater proportion of votes to constitute board action.<sup>62</sup>

(d) *Executive and Other Committees*

For the first time in New York, there is statutory recognition of the propriety of the appointment of an executive and other committees of the board of directors.<sup>63</sup> There must be authorization of this in the certificate of incorporation or by-laws. To the extent provided in the certificate, the by-laws or resolution of the board, committees will have all the authority of the board, except that no committee shall have authority: (1) to submit to shareholders any action that requires shareholder authorization, (2) to fill vacancies in the board or in any committee, (3) to fix the compensation of directors for serving on the board or any committee, (4) to amend or repeal by-laws or make new by-laws, or (5) to amend or repeal any resolution of the board which by its terms is not so amendable or repealable. It is provided that the appointment of any such committee and the delegation of authority to it shall not alone relieve any director of his duty to the corporation as defined in section 717.

(e) *Interested Directors*

A new provision,<sup>64</sup> modelled on the California statute,<sup>65</sup> provides that a transaction is not void or voidable because a director has an interest in it, if (1) the fact of such interest is disclosed to or known by the board of directors and approved by it without counting the vote of the interested director, (2) such interest is disclosed to or known by the shareholders and approved by them without the vote of the interested director as a shareholder, or (3) the transaction is fair as to the corporation at the time of approval by the board or the shareholders.<sup>66</sup>

It is further stated that unless otherwise provided in the certificate or the by-laws, the board of directors will have authority to fix the compensation of directors.

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<sup>62</sup> §§ 707-11. The Del. Code Ann. tit. 8, § 141 (1953) was amended by Ch. 171, Laws 1961, to provide that when all the shares of a corporation are owned beneficially and of record by either one or two shareholders, the number of directors may be less than three but not less than the number of shareholders, and that when a board of one director is authorized then one director shall constitute a quorum.

<sup>63</sup> § 712.

<sup>64</sup> § 713.

<sup>65</sup> § Calif. Gen. Corp. L. § 820.

<sup>66</sup> In *Piccard v. Sperry Corp.*, 48 F. Supp. 465, 467 (S.D.N.Y. 1943), *aff'd*, 152 F.2d 462 (2d Cir. 1946); it was said: "To the extent that *Munson v. Syracuse, G. & C. R. Co.*, 1886, 103 N.Y. 58, 8 N.E. 855, may be said to impose a more rigid standard, it yields to the more moderate view expressed by both prevailing and dissenting opinions in *Everett v. Phillips*, 1942, 288 N.Y. 227, 43 N.E.2d 18."

*(f) Loans to Directors*

A change in the law is made by section 714. The prohibition against loans to shareholders contained in section 59 of the SCL has been omitted because too restrictive. Employees, customers, and even another corporation may hold shares in the corporation and it may be expedient to make loans to any of these. The Penal Law, section 664(4), will still make it a misdemeanor for any director "to receive or discount any note or other evidence of debt with intent to enable any stockholder to withdraw any part of the money paid in by him on his stock." Section 714 prohibits a loan to a director unless it is approved by a vote of the shareholders without counting the vote, as a shareholder, of the director who would be the borrower. A loan made in violation of this section will not for that reason be unenforceable, but the directors approving it will be liable for breach of duty under section 719.

*(g) Officers*

As under present law, officers may be appointed or elected by the board of directors, but, for the accommodation of practices in close corporations, provision is made that the certificate of incorporation may provide that all or certain officers must be elected by the shareholders.<sup>67</sup> Unlike the present law, it is not required that any of the officers must be a member of the board.

An officer chosen by the board of directors may be removed by the board, with or without cause. An officer elected by the shareholders may be removed only by the shareholders, with or without cause, but his authority to act may be suspended by the board for cause. A removal of an officer will not affect any contract rights that he may have. An action to remove an officer for cause may be brought by the Attorney-general or by the holders of ten per cent of the shares, and the removed officer may be barred from re-election or reappointment for a period fixed by the court.

*(h) List of Directors and Officers*

A new provision requires the corporation, upon demand, to furnish a current list of the names and addresses of its directors and officers to a shareholder, creditor, or state official.<sup>68</sup> Such information must be contained in annual franchise tax returns, but it is not available to the public. Listed corporations give the names and addresses of directors

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<sup>67</sup> § 715.

<sup>68</sup> § 718.

and officers in their annual reports and in proxy statements, but that is not generally true of the smaller corporations.

(i) *Duties and Liabilities of Directors and Officers*

There is a codification of the rule that directors and officers must discharge their duties in good faith and with that degree of diligence, care and skill which ordinarily prudent men would exercise under similar circumstances in like positions.<sup>69</sup> Under this standard, a court may measure the director's duty of care according to the kind of corporation involved, the particular circumstances, and the corporate role of the director.<sup>70</sup> It is also provided that, when acting in good faith, they may rely upon financial statements represented to them to be correct by the officer in charge of the corporation's books of account or upon reports of independent accountants.

For the most part, the present instances of the liability of directors are retained, but some others are added to conform to the provisions of this chapter.<sup>71</sup> It is significant that that portion of section 15 of the SCL which prohibits certain transfers to directors, officers, shareholders, or creditors has been omitted from this chapter and so also has the liability of directors or officers concerned in making such prohibited transfers.

The liability of directors, where it exists, is to the corporation for the benefit of shareholders and creditors to the extent of any injury sustained by them. Directors who are made to respond are given new rights: (1) to contribution from other directors similarly liable, (2) to recover an improper dividend or distribution from shareholders who received these with knowledge that they were improper, (3) to rescind an improper corporate purchase of shares from a seller who had knowledge that the purchase was improper, (4) to be subrogated to the rights of the corporation upon payment to the corporation of the claim of any creditor when, after dissolution, assets have been distributed to shareholders without adequately providing for all known liabilities, and (5) to be subrogated to the rights of the corporation upon payment to it of any loan improperly made to a director.

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<sup>69</sup> § 717.

<sup>70</sup> Cf. Shientag, J., in *Litwin v. Allen*, 25 N.Y.S.2d 667, 678 (Sup. Ct. N.Y. County 1940):

In the last analysis, whether or not a director has discharged his duty, whether or not he has been negligent, depends upon the facts and circumstances of a particular case, the kind of corporation involved, its size and financial resources, the magnitude of the transaction, and the immediacy of the problem presented. A director is called upon "to bestow the care and skill," which the situation demands. *New York Cent. Railroad Company v. Lockwood*, 17 Wall. 357, 383, 21 L. Ed. 627 (1873).

<sup>71</sup> § 719.

The presumption of concurrence in board of directors action, limited by section 58 of the SCL to improper dividends and distributions, has been extended to the other enumerated improper transactions.

There is a substantial re-enactment of sections 60 and 61 of the GCL relating to actions against directors and officers for misconduct,<sup>72</sup> but the provisions for removal of directors and officers are separately covered,<sup>73</sup> and the authorization of derivative suits is found in section 626.

*(j) Indemnification of Corporate Personnel*

Indemnification of corporate personnel is regulated by sections 721-25. A distinction is first made between directors and officers and personnel other than directors and officers. Any agreement to indemnify or indemnification of directors and officers is invalid unless consistent with the policy established by these sections, but a corporation is left free to indemnify other personnel by agreement or under common-law principles.

A second distinction is made between the situation where directors and officers are made defendants in an action by or in the right of the corporation and where they are made defendants in other types of actions, *i.e.*, in actions brought by third parties or in criminal proceedings.

They may be indemnified against the reasonable expenses of defending a suit brought by or in the right of the corporation, except as to matters as to which they are adjudged to have breached their duty to the corporation, and the expenses incurred in settling such a pending action may be reimbursed only if authorized by resolution, in a specific case, of a disinterested quorum of the board or, in the absence of such a quorum, by resolution of the shareholders or resolution of the directors upon the written opinion of independent counsel that indemnification would be proper. However, the allowable expenses in connection with an action brought by or in the right of a corporation do not include: (1) expenses incurred in defending or amounts paid in settling any such threatened action, (2) amounts paid in settling any such pending action with court approval, or (3) expenses incurred or amounts paid in disposing of such a pending action without court approval. This is consistent with the provision that a derivative action may not be discontinued without court approval and that the plaintiff in such an action must account to the corporation for anything received by way of judgment or settlement, less his expenses.<sup>74</sup>

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<sup>72</sup> § 720.

<sup>73</sup> §§ 706 and 716.

<sup>74</sup> § 626(d), (e).

A director or officer made or threatened to be made a defendant in any action or proceeding other than one brought by or in the right of his corporation, whether civil or criminal, may be indemnified for his reasonable expenses and any judgment, fine, or amount paid in settlement, if he acted in good faith for a purpose believed to be in the best interests of the corporation. In criminal actions or proceedings indemnification is valid if he had no reasonable cause to believe that his conduct was unlawful. Again, indemnification must be authorized, in a specific case, by resolution of a disinterested quorum of directors or of the shareholders and upon a finding that he has met this standard of conduct.

Even though a corporation has not made provision for indemnification, a court may allow it to the extent that a corporation is permitted to indemnify. A corporation may advance allowable expenses or a court may allow such expenses during the pendency of litigation, but, in either case, the advance must be repaid if the defendant is ultimately found not to be entitled to indemnification or to the extent that the advance exceeded allowable indemnification.

#### AMENDMENTS AND CHANGES

Several changes in existing law are made by article 8. The most important of these is that when an amendment of the certificate of incorporation requires authorization by the shareholders, all such amendments, except where under the new law a greater proportionate vote is required or is authorized to be required by the certificate of incorporation,<sup>75</sup> may be authorized by the vote of the holders of a majority of the shares entitled to vote thereon, rather than, as under present law, by two-thirds as to some amendment and a majority as to others. This accords with the present practice in twenty other American jurisdictions. The right to vote by classes on certain amendments, as given by sections 35 and 51 of the SCL is continued.<sup>76</sup> Furthermore, some routine changes may be authorized by the board of directors rather than by the shareholders, for example, a change in the location of the corporation's office or of the address to which the Secretary of State is to mail a copy of process against the corporation served upon him, or the designation, revocation, or change of a registered agent or of his address. As previously indicated, the board of directors may also have been given authority to amend the certificate to designate the series into which a

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<sup>75</sup> § 803.

<sup>76</sup> § 804.

class of shares is fixed by the board<sup>77</sup> or an amendment eliminating reacquired shares from the number of authorized shares.<sup>78</sup>

A corporation formed by special act is permitted to make any of the amendments that may be made by a corporation formed under a general law.<sup>79</sup> This is a change in the effect of section 38(5) of the SCL.

As uniformly required by the new law as to other certificates, the certificate of amendment is to contain all the facts which the present law requires to be set forth in a separate affidavit annexed to the certificate,<sup>80</sup> and section 104 supplies a uniform provision as to signing, filing, and the effect of filing certificates.

There are slight changes as to a restated certificate of incorporation.<sup>81</sup> Shareholder approval is not required if the restated certificate includes only changes or amendments which could be authorized by the board of directors. Statements in the original certificate, which are no longer of consequence, as to the original incorporators, subscribers for shares, and directors need not be included. The approval of a public officer, which might normally be a condition precedent to the filing of a certificate of incorporation or an amendment, is not required if such approval had been previously obtained and the restated certificate contains no further amendment. When filed, the restated certificate becomes the certificate of incorporation, rather than presumptive evidence of incorporation as under section 40(9) of the SCL.

#### MERGER OR CONSOLIDATION; DISPOSITION OF ASSETS

##### (a) *Merger or Consolidation*

A clearer distinction is made between a merger of a corporation into a surviving corporation and the consolidation of corporations into a newly formed corporation,<sup>82</sup> but the procedure to accomplish either is the same, but with some changes of the present law.<sup>83</sup> A plan of merger or consolidation must initially be approved by the board. Notice of the meeting for shareholder approval of the plan must be given to the holders of all outstanding shares, whether or not entitled to vote, but adoption of the plan requires the vote only of the holders of two-thirds of shares entitled to vote. The principle of class voting, as set forth in section 51 of the SCL, is retained if the plan effects a change which, if con-

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<sup>77</sup> § 502(c), (d).

<sup>78</sup> § 515.

<sup>79</sup> § 801(c).

<sup>80</sup> § 805.

<sup>81</sup> § 807.

<sup>82</sup> § 901.

<sup>83</sup> §§ 902-07.

tained in an amendment to the certificate of incorporation, would entitle the holders of a class of shares to vote as a class.<sup>84</sup>

The provisions in sections 85 and 91 of the SCL for a merger of parent and subsidiary corporations and for merger or consolidation of domestic and foreign corporations are retained with only slight changes.<sup>85</sup> It is provided that when the transaction involves domestic and foreign corporations, the merger or consolidation becomes effective on the date when the certificate is filed or on such subsequent date as is stated in the certificate.<sup>86</sup> This is to permit synchronization of the procedures required in the different jurisdictions.

The appraisal rights of dissenters to mergers or consolidations remain unchanged.<sup>87</sup>

### (b) *Disposition of Corporate Assets*

It is recognized that the board of directors, in the exercise of the general powers of a corporation, may authorize a sale, lease, or exchange of the corporation's property when that is done in the regular course of business,<sup>88</sup> and the rule is retained that if the transaction is not in the regular course of business, it must have the approval of the holders of two-thirds of the shares entitled to vote thereon.<sup>89</sup> With respect to the latter type of transaction, the language of section 20 of the SCL, "not made in the regular course of business of the corporation," has been changed to "not made in the usual or regular course of the business regularly conducted by such corporation," and the reference is to "all or substantially all the assets of the corporation" without the addition of "or an integral part thereof essential to the conduct of the business of the corporation."<sup>90</sup> It is required that notice of such a proposed transaction be given to all shareholders, whether or not entitled to vote. The board of directors may abandon a proposed disposition of assets despite prior approval thereof by the shareholders.

One substantial change is made as to the appraisal rights of dissenters. If the sale is wholly for cash and if there is to be an ensuing dis-

<sup>84</sup> § 903.

<sup>85</sup> §§ 905 and 907.

<sup>86</sup> § 907(g).

<sup>87</sup> § 910.

<sup>88</sup> § 202(a)(5).

<sup>89</sup> § 909.

<sup>90</sup> See Fuld, J., dissenting in *Eisen v. Post*, 3 N.Y.2d 518, 527, 146 N.E.2d 779, 783, 169 N.Y.S.2d 15, 21 (1957). The corporation was formed to deal in real estate. Its only asset was a lease of property on which, during all its life, it had operated a theatre. The minority view was that the purpose of SCL § 20 was to protect a shareholder against a change in the business in which he invested, i.e., a change in the business actually conducted, not the business it may have been authorized to pursue. Therefore, the sale of the leasehold should require shareholder approval.

solution of the corporation, all shareholders will receive their proportionate interest in the assets of the corporation upon liquidation. Therefore, the dissenters are denied the right of appraisal under these circumstances.<sup>91</sup> This corresponds with a similar provision made in connection with a sale of corporate assets after dissolution.<sup>92</sup>

#### NONJUDICIAL DISSOLUTION

The chief accomplishment of the new law with respect to nonjudicial dissolution is to separate and simplify the twelve numbered paragraphs of section 105 of the SCL and the eleven numbered paragraphs of section 106. The theory of the new law is (1) that dissolution is effected when the certificate of dissolution is filed, (2) that thereafter the board has authority to do nothing but proceed with the liquidation, and (3) that there is no need for the supplementary certificate of termination of corporate existence which was authorized by section 105 but which was seldom, if ever, filed. A present provision, peculiar to dissolution, requires the Department of State to issue duplicate certificates that a certificate of dissolution has been filed and that the corporation is dissolved and to send one copy to the county clerk and the other to the corporation. This practice is discontinued and the Department of State will transmit a certified copy of the certificate of dissolution to the county clerk, a procedure made uniform throughout the new act.<sup>93</sup>

It is emphasized in the new law that, after dissolution, the directors of a dissolved corporation are not to be regarded as "trustees" of its assets and that title to such assets does not vest in them but remains in the corporation until transferred by it in its name.<sup>94</sup> As already indicated, if there be a sale of assets for consideration that is in part other than cash, dissenters are given a right of appraisal but payment to them is to be made by the corporation and not by "the stockholders consenting to such sale" as in section 105(9) of the SCL.<sup>95</sup>

Notice to creditors to file claims may be given "at any time after dissolution"<sup>96</sup> rather than "at any time after three years from the filing of the certificate," and the notice must allow not less than six months for filing claims rather than not less than forty days. Persons having un-

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<sup>91</sup> § 910. Cf. *Matter of Roehnar v. Gracie Mansion, Inc.*, 6 N.Y.2d 280, 160 N.E.2d 519, 189 N.Y.S.2d 644 (1959), holding that SCL § 20 did not apply when a sale of the corporation's only asset was pursuant to a plan for dissolution, even though the dissolution was not carried out.

<sup>92</sup> § 1004(a)(3)(A).

<sup>93</sup> § 104(g).

<sup>94</sup> § 1005(a)(1).

<sup>95</sup> § 1004(a)(3)(A).

<sup>96</sup> § 1006(a).

liquidated or contingent claims are included among those entitled to the notice and among those whose claims will be barred if not presented within six months. Upon the completion of liquidation, assets distributable to a creditor or shareholder who is unknown or cannot be found or who is under a disability are to be paid to the state comptroller under the Abandoned Property Law.

At any time after dissolution, the supreme court may be petitioned to continue the liquidation under its supervision and the corporation has been added as a possible petitioner.<sup>97</sup> A provision has been added for an injunction restraining any creditor from beginning any action against the corporation, restraining the corporation from conducting any business other than that incident to liquidation or any collection, payment, or distribution of funds except upon court order. Under section 111 of the GCL, an injunction could be granted only if a receiver had been appointed, and, under section 110 of the GCL, a receiver could be appointed only if the corporation were insolvent. These limitations have been omitted.

#### JUDICIAL DISSOLUTION

##### (a) *Action by the attorney general*

The provisions in sections 90, 91 and 92 of the GCL that the attorney general must bring an action if so directed by the legislature and that he must petition a court for leave to bring an action for dissolution have been omitted. Omitted also are the grounds for such an action stated in sections 30 and 71 of the GCL, namely, that the corporation has not begun business within two years after incorporation or has remained insolvent for at least a year. As to the first, adequate relief exists under the Tax Law<sup>98</sup> which empowers the attorney general to bring an action to forfeit the charter or dissolve a corporation that has intentionally failed to file reports or pay taxes and empowers the Secretary of State to declare dissolved a corporation that has not filed reports or paid taxes for three years. As to the second, the remedies of creditors under article 12 and of shareholders under article 11 can adequately take care of a condition of insolvency. The grounds listed for an action by the attorney general are those stated in section 91 of the GCL with a proviso that those enumerated shall not exclude other causes for dissolution under this law or any other statute of the state.<sup>99</sup> The authority of the attorney general under section 92(2) of the GCL to

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<sup>97</sup> §§ 1007(a)(8) and 1116.

<sup>98</sup> N.Y. Tax Law §§ 203, 203-a, and 216.

<sup>99</sup> § 1101.

subpoena witnesses and take proof in connection with any such proposed action is preserved.<sup>100</sup>

(b) *Petition by Directors or Shareholders*

There are no substantial changes under this heading. For the provision that the board of directors must file a petition, if so directed by resolution adopted by the holders of a majority of the shares entitled to vote, there has been substituted the provision that, after such a resolution, the shareholders or such of them as are designated for that purpose in the resolution may present the petition, and the holders of ten per cent of the shares entitled to vote on the question are permitted to call a meeting to consider a proposal to file a petition.<sup>101</sup>

(c) *Petition by Shareholders in Case of a Deadlock*

In addition to the grounds that the directors are so divided that they cannot act or that the shareholders are so divided that directors cannot be elected, there is added a provision intended to make clear that dissension among shareholders, particularly in small corporations, which makes continued association unworkable is also a reasonable ground for dissolution,<sup>102</sup> and further emphasis is given to this point by providing that, upon a petition in the case of a deadlock, dissolution is not to be denied merely because the corporate business has been or could be conducted at a profit.<sup>103</sup> It is indicated also that, though public interest may be a factor in deciding upon an application by the attorney general, in an application by shareholders, it is their interests which should guide the decision. There can be no public interest in perpetuating dissension.

An innovation in the statutory law is the provision that the certificate of incorporation may contain, or be amended to contain, a provision that any shareholder, or the holders of any specified number or proportion of shares, may enforce dissolution, at will or upon the occurrence of any specified event.<sup>104</sup> A shareholders' agreement for dissolution would probably be held valid in the absence of this statutory recognition of its validity.<sup>105</sup> Since such a provision is required to be in the certificate of incorporation and by unanimous consent, its use would be feasible only in a close corporation, and the anticipated condition would normally be

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<sup>100</sup> § 109.

<sup>101</sup> §§ 1102 and 1103.

<sup>102</sup> § 1104.

<sup>103</sup> § 1112(b)(3).

<sup>104</sup> § 1105. This section has now been transferred to Article 10 as § 1002 to make clear that dissolution under such an agreement can be effected by filing a certificate of dissolution. The change necessitated a renumbering of sections in Articles 10 and 11.

<sup>105</sup> See, however, a statement upon this point in *Benintendi v. Kenton Hotel, Inc.*, 294 N.Y. 112, 118, 60 N.E.2d 829, 831 (1945).

a state of deadlock or dissension. In view of the reluctance of courts to order dissolution in cases of deadlock and dissension,<sup>106</sup> a useful supplement to the procedure by petition is supplied by this provision.

Another new provision is that which gives a single shareholder the privilege of petitioning for dissolution when the hopelessness of the deadlock is indicated by the fact that two annual meetings have passed without being able to elect directors.<sup>107</sup>

(d) *Applicability of other Provisions*

The provisions of article 10 relating to procedure after dissolution, notice to creditors, and the filing and barring of claims, and the powers of a court to supervise liquidation, are, by reference, made applicable to judicial dissolution.<sup>108</sup>

#### RECEIVERSHIP

Article 11 includes GCL section 70—Action for sequestration—and a consolidation and simplification of the many sections relating to receivers in articles 10, 11, and 12 of the GCL. This process involved some rewording and some revision but with very few substantial changes.

#### FOREIGN CORPORATIONS

As stated at the outset, the constant objective of the Joint Legislative Committee was to have the new Business Corporation Law represent the proper balance of the interests of shareholders, management, employees, and the overriding public interest. Having adhered to that as the policy that should be embodied in the corporation law of New York, the Committee was confronted with the problem of what should be the law of New York with regard to foreign corporations engaged in business in New York. It was strongly urged before the Committee that the policy of other states should be respected and that foreign corporations should be subject to and regulated by the law of the jurisdiction of incorporation, not by the law of New York.<sup>109</sup> Many corporations engaged in a nation-wide business are incorporated in other states. Their activity in this state should not, it was argued, be discouraged by subjecting them,

<sup>106</sup> *Matter of Radom & Neidorf, Inc.*, 307 N.Y. 1, 119 N.E.2d 563 (1954). For further discussion and additional citations, see Henn, *Corporations*, § 280 (1961), and 2 Hornstein, *Corporation Law and Practice*, § 789 (1959).

<sup>107</sup> § 1104(c).

<sup>108</sup> §§ 1004-07.

<sup>109</sup> Model Business Corporation Act § 99 reads in part:

A foreign corporation shall not be denied a certificate of authority by reason of the fact that the laws of the state or country under which such corporation is organized governing its organization and internal affairs differ from the laws of this State, and nothing in this Act contained shall be construed to authorize this State to regulate the organization or internal affairs of such corporation.

because of those activities, to the regulatory provisions and to the individual liability of their directors, officers, and shareholders peculiar to New York and not imposed by the law of the state of incorporation. On the other hand, it seemed obvious that it would be futile to enact into law what is considered a sound policy towards New York corporations if that law could be evaded by going to some other state to incorporate with the purpose of returning to New York to do business here. The new law has been drafted with the acceptance of these distinctions as a premise, and a significant change in the present law is to have the provisions of the new act apply to domestic corporations and, with a few exceptions, only to a foreign corporation defined as a "domiciled foreign corporation," that is, one of which "(1) at least two-thirds of all its outstanding shares, with or without voting rights, are owned, either beneficially or of record, by residents of this state, or (2) at least two-thirds of all its outstanding shares with voting rights are owned, either beneficially or of record, by residents of this state, or (3) at least two-thirds of its business income or its investment income is allocable to this state for franchise tax purposes under the tax law."<sup>110</sup> This cuts down the effects of section 114 of the SCL which subjects the directors, officers, and shareholders of a domestic corporation for making (1) unauthorized dividends, (2) unlawful loans to shareholders, (3) false certificates, reports, or public notices, (4) illegal transfers of the stock and property of the corporation when it is insolvent or its insolvency is threatened.<sup>111</sup> Under the new law, there is imposed upon the directors and officers of a domiciled foreign corporation the same liability that is imposed upon the directors and officers of a domestic corporation for declaring dividends or making other distributions to shareholders, purchasing its own shares or making loans to directors that would be contrary to the provisions of the act, and they are made accountable for any other official misconduct.<sup>112</sup> A domiciled foreign corporation is required, in the same manner as a domestic corporation, to give those shareholders who are residents of New York notice of the effect that any transaction would have upon capital surplus or stated capital,<sup>113</sup> and the provisions as to indemnification of directors and officers are made appli-

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<sup>110</sup> § 1317. This definition is subject to change. Note, 47 Cornell L.Q. 273 (1962).

<sup>111</sup> Three other states have similar provisions in varying language: Mass. Ann. Laws ch. 181, § 14 (1955); Mich. Stat. Ann. § 21.95 (1956); and Tex. Rev. Civ. Stat. Ann. art. 8.01 and 8.02 (1956). As to SCL § 114, loans to directors are prohibited unless approved by the shareholders, and so much of SCL § 15 which prohibited transfers of corporate property when insolvent or when insolvency is threatened has been omitted. But cf. N.Y. Penal Law §§ 664 and 667.

<sup>112</sup> § 1318.

<sup>113</sup> § 1319.

cable to it.<sup>114</sup> Applicable to all foreign corporations are to the extent stated therein, articles 1 and 3, the other provisions of article 13, and the provisions relating to dissenters' rights in mergers or consolidations of domestic and foreign corporations, derivative actions, and security for expenses therein and reorganization under act of Congress.<sup>115</sup>

There are other changes in the law relating to foreign corporations. A foreign corporation intending to apply for authority to do business in the state may reserve its name, and a person intending to form a foreign corporation and then apply for such authority may reserve its proposed name.<sup>116</sup> The application for authority must designate the Secretary of State as agent for service of process against the corporation, but may also designate a registered agent for that purpose.<sup>117</sup> The application must include a statement that the corporation has not theretofore engaged in activity in the state, or, in lieu thereof, the consent of the state tax commission to the filing of the certificate must be attached to it.<sup>118</sup> This is to supplement section 1312 which is a change in section 218 of the GCL. The latter denied a foreign corporation the right to sue in the courts of New York upon any contract made before it had obtained authority to do business here. The new provision denies it the right to maintain any cause of action or special proceeding unless and until it has received authority to do business and has paid all fees, penalties, and taxes for the period in which it did business without authority. A foreign corporation will no longer be required to keep a record of its shareholders in this state, but will be required to produce it upon the request of a qualified shareholder, and, in the event of a wrongful refusal of the request, the shareholder may apply for an order compelling production and for such other relief as to the court may seem just.<sup>119</sup>

New grounds for an action by the attorney general to annul the authority or to enjoin a foreign corporation from doing business in the state have been added. Such an action may be brought where the corporation's authority was obtained through a fraudulent misrepresentation or concealment of a material fact, or where it has done or omitted any act for which a domestic corporation could be dissolved.<sup>120</sup>

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<sup>114</sup> § 1320(b).

<sup>115</sup> § 1320.

<sup>116</sup> § 303.

<sup>117</sup> §§ 1304 and 305.

<sup>118</sup> § 1304(a)(7).

<sup>119</sup> § 1315.

<sup>120</sup> § 1303.