

7-1-1960

Corporations and Corporate Finance

Hugh L. Sowards

Follow this and additional works at: <https://repository.law.miami.edu/umlr>

Recommended Citation

Hugh L. Sowards, *Corporations and Corporate Finance*, 14 U. Miami L. Rev. 575 (1960)

Available at: <https://repository.law.miami.edu/umlr/vol14/iss4/5>

This Article is brought to you for free and open access by the Journals at University of Miami School of Law Institutional Repository. It has been accepted for inclusion in University of Miami Law Review by an authorized editor of University of Miami School of Law Institutional Repository. For more information, please contact library@law.miami.edu.

CORPORATIONS AND CORPORATE FINANCE

HUGH L. SOWARDS*

SHAREHOLDERS' RIGHTS

Voting — Proxies

Shareholder voting by written proxy is permitted in Florida.¹ Proxies are either general or special. A general proxy entitles the person casting the vote at the meeting to use his discretion in voting, but the holder of a limited proxy is authorized to vote on certain matters only or in a certain manner. This distinction was brought into sharp focus in the case of *State ex rel. Halvey v. Coogan*.² P, a shareholder, obtained proxies from other shareholders to vote their stock in favor of a proposed amendment to the corporate by-laws. The proxies were general in form. Before P could bring the proposed amendment to a vote, another shareholder interjected an amendment to the proposal which materially altered its purpose. P voted his proxies against the new proposal, but the chairman refused to count P's proxies on the ground that P was authorized to vote them only in favor of the proposed amendment. The court held that since P's proxies were general in form, the chairman had no power to limit their use, thus recognizing the aforementioned distinction between general and limited proxies.

Directors — Removal by Shareholders

P, the president of a corporation, became its sole shareholder and director upon its organization and the resignation of two "dummy" incorporators and directors. As the remaining director, P designated A and B to fill the vacancies on the board created thereby.³ The directors then adopted a resolution authorizing only A and B to draw checks on the corporate bank account. Later, at a special but informal meeting of the board, P was removed as president by a 2-1 vote. That same day P called a special stockholders' meeting, and, as sole stockholder, removed A and B as directors and elected himself and two other persons as directors. At this time there was no charter or by-law provision for removal of directors, but P voted to amend the by-laws so as to authorize removal without cause. The "new board" then authorized only P to draw checks on the corporate bank account. P then sought a declaratory decree declaring him to be the president and an injunction restraining A and B

*Professor of Law, University of Miami.

1. FLA. STAT. § 608.10(5) (1955).

2. 98 So.2d 757 (Fla. App. 1959).

3. FLA. STAT. § 608.08(2) (1955): "Vacancies in the board of directors shall be filled until the next annual meeting of stockholders by the directors remaining in office unless otherwise provided in the certificate of incorporation."

from acting as directors of the corporation and requiring the bank to honor only P's signature on the corporation's checking account. Relief was denied.⁴

The analysis of the court serves as a practical lesson in corporate procedure. First, it was observed that officers serve only at the pleasure of directors.⁵ Therefore, P's removal as president by A and B was valid. Second, the fact that the meeting at which P was removed was an informal one did not affect its validity inasmuch as all directors were present and participated.⁶ Next, P (at the special meeting which he called) had no power to remove A and B without cause prior to the next regular annual meeting of shareholders, even though A and B were originally not elected by the shareholders but only designated to fill vacancies.

The case underscores the principle that, in the absence of statute⁷ or provision in the certificate of incorporation or by-laws, a director cannot be removed from office before the expiration of his term, except for cause. The rule may be criticized as unsound in that it denies the real owners of a business the right to remove their agents, although those agents may have become unsatisfactory to their principals, the shareholders. The answer given, however, is that, unlike officers, who are agents serving at the pleasure of the board, directors are more akin to public officers who have been elected to a fixed term of office. Further, that the statutes requiring that corporations shall be managed by their directors would have no meaning if directors were subject to an ever-present threat of removal; directors would be mere men of straw. The decision of the Florida court in this case, while open to criticism for the above reasons, is in line with the law in most jurisdictions.⁸

Voting Trusts

Although voting trusts are authorized by statute in Florida,⁹ the statute does not sanction their use for any purpose; a valid business objective must exist or the voting trust will be held illegal as against

4. *Frank v. Anthony*, 107 So.2d 136 (Fla. App. 1958).

5. See FLA. STAT. § 608.40 (1955).

6. See *Etheredge v. Barrow*, 102 So.2d 660, 663 (Fla. App. 1958). (Where all of the directors and shareholders of a close corporation were present and participated in discussion of a corporate matter, a decision made on the matter was held valid although the meeting was not a formal one.)

7. Although Florida has no statutory provision for removal of directors, the corporate codes of California (Sec. 810), Minnesota (Sec. 29), Pennsylvania (Sec. 405) and North Carolina (Sec. 55-27) provide for removal of a director without cause by majority vote.

8. The suggestion might be advanced that P, at the special meeting of shareholders, could have amended the by-laws so as to increase the number of directors and regain the balance of voting power by "loading" the board. But even this avenue is not open to him, for the statute provides that, "An increase in the number of directors shall create vacancies for the purpose of this section . . . Vacancies . . . shall be filled . . . by the directors remaining in office." (Emphasis added.) FLA. STAT. § 608.08(2) (1955).

9. FLA. STAT. § 608.43 (1955).

public policy. In *Central Bank & Trust Co. v. Davis*,¹⁰ the officers and directors of a financially embarrassed corporation, in order to forestall suit by a creditor, established voting trusts of all their stock. These voting trusts were created in good faith and did not result in placing beyond reach of the creditor any assets. Since the voting trusts were established in good faith and for a legitimate business purpose, the court refused to set them aside.¹¹

LIABILITIES AND LOYALTIES OF DIRECTORS

It is a familiar principle of corporation law that corporate officials occupy a fiduciary relation to the corporation. Such a relationship calls for undivided loyalty on the part of the official. He will be held accountable for personal profits arising from opportunities which rightfully belong to the corporation or for profitable activities which stem from a conflict of interest.¹² In *Renpak v. Oppenheimer*¹³ a Florida court, while paying lip service to this principle, failed to apply it. D, an officer, director, stockholder and managing employee of P Corporation, *while occupying those capacities*, secretly agreed with two of P's employees to form a competing business and was instrumental in inducing some of P's customers to transfer their accounts to the new business. Equitable relief was denied to P. The court stressed the fact that the defendants did not begin operation of the competing business until after the severance of their relationship with P, but added that, ". . . nor is there any dispute that planning and negotiations were under way before [defendants] had severed their connections. . ."¹⁴ The court also observed that officers and directors may enter into a competing business if they do so in "good faith." This portion of the opinion is disturbing. It is difficult to imagine how directors may plan and negotiate with respect to a competing business in good faith during their service as directors. The apparent conflict of interest and exposure of their integrity to selfish temptation is entirely inconsistent with their fiduciary relationship.¹⁵

10. 102 So.2d 600 (Fla. 1958).

11. See also the companion case of *Southern Creosoted Lumber Co. v. Morales*, 113 So.2d 425 (Fla. App. 1959).

12. See *Etheredge v. Barrow*, 102 So.2d 660 (Fla. App. 1958) (Corporate official not liable for breach of trust where he purchased corporate property at a tax sale with the knowledge and consent of all other directors and shareholders).

13. 104 So.2d 642 (Fla. App. 1958). The case is noted in 13 U. MIAMI L. REV. 483 (1959).

14. 104 So.2d at 644.

15. The case is to be contrasted with another recent case, *Cushman v. Schubert*, 110 So.2d 703 (Fla. 1959), where defendants, who were joint venturers with plaintiff, formed a corporation and neglected to assign a land contract to it but instead assigned the contract to another corporation. The court, in holding that the contract rightfully belonged to the first corporation, charged defendants with "the duty of the finest and highest loyalty . . . A trustee is held to something stricter than the morals of the market place." *Id.* at 705.

The fiduciary relationship of directors to their corporation was emphasized in *Armenian Hotel Owners, Inc. v. Kulhanjian*,¹⁶ where minority shareholders instituted an equitable action against directors who fraudulently had assigned the corporation's principal asset. The directors were held accountable as constructive trustees for corporate losses resulting from the assignment. In addition, the assignee, although not a director, had been guilty of participation in the assignment to him. He, too, was held accountable as a constructive trustee.

INSPECTION OF BOOKS AND RECORDS

As one of the owners of his company, a shareholder has the right to inspect corporate books and records. But the right is not an absolute one. If the purpose of his inspection is improper, the right will be denied. At the common law it is necessary to allege inspection for a proper purpose, but under a current Florida statute¹⁷ no such allegation is necessary. The statute, however, covers stock books only. Thus the common-law rule is still in effect with respect to all other corporate books and records. In *State ex rel. Fussell v. McLendon*,¹⁸ P, owning 20 per cent of D Corporation's shares, requested inspection of D's corporate books and records to ascertain the value of her stock, to determine availability of corporate funds for dividends, and to determine whether the affairs of the corporation were being properly administered by the officers in charge. Upon refusal of inspection, P brought a writ of mandamus. In holding that the above three purposes were proper, the court observed that inasmuch as the statute previously referred to is concerned solely with the right to inspect stock books, it in no way abrogated the common-law right to inspection of other corporate books and records.

In *Florida Telephone Corporation v. State of Florida ex rel. Peninsular Telephone Company*,¹⁹ P, owner of more than one per cent²⁰ of D's stock, sought, under the authority of the inspection statute, to examine D's stock book for the purpose of compiling a list of the names, addresses and respective stockholdings of D's shareholders, with the ultimate objective of gaining control of D. In the subsequent mandamus proceeding D

16. 96 So.2d 146 (Fla. 1957). The decision was later modified by crediting the defendant-assignee with the amount expended by him in obtaining the lease assignment. *Papazian v. Kulhanjian*, 107 So.2d 129 (Fla. 1958).

17. FLA. STAT. § 608.39 (1953). Prior to its repeal in 1953, another statute, FLA. STAT. § 611.23 (1951), provided for examination of all corporate books and records at a reasonable time and place, without having to resort to mandamus, by a shareholder or shareholders owning not less than one-tenth of the stock. No allegation of inspection for a proper purpose was necessary. See *Soreno Hotel v. State ex. rel. Otis Elevator Co.*, 107 Fla. 195, 144 So. 359 (1932).

18. 109 So.2d 783 (Fla. App. 1959).

19. 111 So.2d 677 (Fla. App. 1959).

20. "The stock book or stock lists shall be open . . . for inspection by any judgment creditor of the corporation or any person who shall have been for at least six months immediately preceding his demand a record holder of not less than one per cent of the outstanding shares of such corporation . . ." FLA. STAT. § 608.39 (1955).

defended on the ground that P had alleged no specific purpose for securing the information. The court correctly held that the statute amplified and expanded common-law inspection rights by removing the common-law restriction of alleging a proper purpose as a condition precedent to the right of inspection of stock books. A further defense, that P's desire to gain control constituted an improper purpose, was also unsuccessful. The court realistically disposed of this defense by remarking that, "The protection of interest by purchasing additional stock is a perfectly legitimate enterprise . . . The desire to gain control is repugnant only to those seeking its retention or more of the same."²¹

EXECUTIVE COMPENSATION

Three recent Florida cases involved the validity and reasonableness of compensation to corporate officials when that compensation was fixed by the officials themselves.²²

Generally speaking, directors have power to determine the compensation paid to corporate officers. But suppose that some of the directors are also officers. It is a familiar rule of corporate law that directors cannot fix their own compensation unless expressly authorized by the charter or the shareholders.²³ Thus if a director's presence or vote at a meeting is necessary to the passage of a resolution fixing his own compensation, three views exist with respect of the validity of the resolution: (1) the resolution is void; (2) the resolution is voidable at the option of objecting shareholders; (3) the resolution is voidable at the option of objecting shareholders upon a showing that the compensation is unfair and unreasonable. A Florida court has adopted the third view.²⁴ Although the president cast the deciding vote in his own favor on a resolution increasing his compensation, the court refused to grant a summary judgment requested by an objecting shareholder, holding that there was a material question of fact as to the reasonableness of the salary increase. Of course, had the court adopted the view that the resolution was voidable without any showing of unfairness, no question of reasonableness would have been considered. The view taken by the Florida court is in line with a recent trend in other jurisdictions.²⁵ In short, the reasoning behind this trend proceeds from the premise that courts should not interfere in internal

21. *Florida Tel. Corp. v. State of Florida ex. rel. Peninsular Tel. Co.*, 111 So.2d 677, 681 (Fla. App. 1959).

22. *Florida Flight & Eng. Corp. v. Shelton*, 103 So.2d 615 (Fla. 1958); *Sarasota Tile & Terrazo Corp. v. DeSoto Terrazo Corp.*, 105 So.2d 811 (Fla. App. 1958); *Hackley v. Oltz*, 105 So.2d 20 (Fla. App. 1958).

23. See, e.g., *Redstone v. Redstone Lumber & Supply Co.*, 101 Fla. 226, 133 So. 882, 884 (1931).

24. *Sarasota Tile & Terrazo Corp. v. DeSoto Terrazo Corp.*, 105 So.2d 811 (Fla. App. 1958).

25. See *Church v. Harnit*, 35 F.2d 499 (6th Cir. 1929), *cert denied*, 281 U.S. 372 (1930).

affairs except in cases where such interference is essential to justice, or, more particularly, in the executive compensation cases, where the compensation is clearly unreasonable. Granting the soundness of this premise, it is nevertheless submitted that the burden of proving reasonableness and fairness should be on the interested director. But the court indicated that the burden of proof rested with the one attacking the compensation, as in cases where the compensation is determined by wholly disinterested members of the board.²⁶

In another recent case²⁷ directors fixed their own salaries and voted themselves bonuses after they had rendered services to the corporation. The bonuses were determined by a formula providing for bonus payments equal to approximately 20 per cent of the corporate income. The formula made no reference to services rendered to the corporation by the directors. The court held that the plaintiffs did not have to prove fraud on the part of the defendants in order to be entitled to relief. The case is squarely in line with the majority position that bonuses must be based upon some reasonable relationship to the services performed or will be vulnerable to attack on the basis that such payments are in reality gifts, which are subject to unanimous stockholder approval.

A third recent Florida case on executive compensation may well become a leading one on the subject if for no other reason than the fact that it involved multiple forms of claimed compensation from the standpoint of both validity and reasonableness. *Flight Equipment & Engineering Corp. v. Shelton*²⁸ should serve well as a compensation guide to both corporate attorneys and executives. The case presented a controversy between a former corporate official and the corporation over various types of compensation paid to the official during his tenure of office, as follows: bonus, cancellation of a debt owed by the official to the corporation, insurance premiums paid on the official's life with corporate funds, overtime pay, and expenses incurred by the official.

With respect to a bonus of \$10,000, the official had directed its payment at a time when his compensation had been frozen by the Salary Stabilization Board. The fact that the corporate directors subsequently "ratified" the official's bonus payment was held to be immaterial, on the basis that they had no power to ratify a void or illegal act. Next, the official, without authority, had caused cancellation of a debt owed by him to the corporation, treating the saving as an additional bonus. Inasmuch as there was no authority for the cancellation and no ratification of it,

26. "[T]he order of the board was not void but was voidable at the suit of the minority stockholders on a cogent showing by *them* that the salary fixed . . . was clearly excessive and wasteful as against the minority." (Emphasis added.) *Sarasota Tile & Terrazo Corp. v. DeSoto Terrazo Corp.*, *supra* note 24, at 812.

27. *Hackley v. Oltz*, 105 So.2d 20 (Fla. App. 1958).

28. 103 So.2d 615 (Fla. 1958).

the corporation was held entitled to recover the amount owed. In addition, the official had used corporate funds to pay insurance premiums on his own life. Again, he was not authorized to take such action. He argued, however, that the corporation was estopped to deny his authority because the payments were shown on the corporate books and because the carrying of such insurance coverage was standard procedure in numerous corporations. The court properly reasoned that there was no basis for estoppel due to the fact that the official at the time was in complete control of the corporation's fiscal and management affairs and therefore could not claim the benefit of estoppel or procedure in other corporations as excuses for his own unauthorized acts. During his tenure in office the official had collected overtime pay, on the basis that he was a "salaried" employee" of the corporation and therefore entitled to additional compensation for all hours worked in excess of 40 in each week. In refuting this argument the court distinguished between a corporate officer and an ordinary employee, holding that an officer must devote such time and effort to the performance of his duties as is reasonably required of him. Unlike an employee, he is not required to work a specified schedule of hours. Furthermore, the court observed that an officer's compensation is properly fixed by the directors and that he is without authority to fix or increase his own compensation.²⁹ Finally, the official had received expenses in the form of a car allowance and car rentals. Since the trial court had found these expenses to have been reasonably incurred for the benefit of the corporation, the official was held legally entitled to be reimbursed for such of them as were properly accounted for by him. However, the official had also charged the corporation with an expense for the appointment of a receiver in bankruptcy proceedings. This corporate expense, having been incurred as a result of the official's negligent and unauthorized act, was held to be recoverable by the corporation.

Three other recent cases dealt with indirect compensation in the form of stock options and stock allotments.³⁰

LEGISLATION

The 1959 session of the Florida Legislature produced several changes in the Florida Securities Act³¹ and one in the Corporate Code.³²

29. See discussion of Sarasota Tile and Hackley cases, *supra*.

30. *Coach Cities Coaches, Inc. v. Whyte*, 102 So.2d 848 (Fla. 1958) (corporation held entitled to deduct corporate indebtedness in determining fund out of which debt to plaintiff was to be repaid under agreement that such debt was to be satisfied out of "net earnings"); *Calhoun v. Corbisello*, 100 So.2d 171 (Fla. 1958) (plaintiff failed to recover an amount paid by him on an option to purchase all of the outstanding shares held by defendants in the corporation due to his own failure to perform); *Goldfarb Novelty Co. of Florida v. Vann*, 94 So.2d 845 (Fla. 1957) (corporation held obligated to pay plaintiff under an agreement whereby he was employed as its manager and salesman and was to receive as partial compensation for his services a certain number of shares of stock).

31. FLA. STAT. ch. 517 (1951).

32. FLA. STAT. ch. 608 (1953).

With respect to the Florida Securities Act, the Florida Securities Commission, for the first time, was granted specific rule-making power. Heretofore, the "rules and regulations" of the Commission have been issued sporadically in the form of mimeographed "releases." Securities attorneys soon learn of the marked difference which exists between SEC and state administrative practice in this respect. On the federal level there are exhaustive (and sometimes exasperating) rules and regulations for almost every conceivable situation, while on the state level the absence of formality is the rule rather than the exception. Flexibility is the order of the day. This state of affairs can be both good and bad—from the viewpoint of the securities attorney and his client. By way of illustration, an SEC examiner is bound to act within well-defined limitations, but a state securities examiner, restricted by no set of rules, can "bend over backwards" to grant a concession. By the same token, the state examiner can be arbitrary and "make *ad hoc* determinations in a way which would have shocked the SEC during the most halcyon days of the New Deal."³³ Most Florida attorneys will welcome a well-defined set of rules and regulations in this area, that is, if the Commission sees fit to draft and adopt them.

The Florida Securities Act lists a number of exempted securities—securities which may be sold to the public without registration and attendant scrutiny by the Commission. Among these exempted securities was short-term commercial paper, such as negotiable promissory notes which mature in a year or less. As securities prices advanced during the late 1950's, an avid investing public rushed into the market on a gigantic scale. With this influx of new speculative money came charlatans and other types of securities fraud artists. The practice grew up of offering a 15 per cent return on short-term paper, often "secured" by lien on worthless or near-worthless realty or personal property. Of course, in order to pay a 15 per cent return, the issuer of such paper would have to earn as high as 25 per cent on the invested funds. Needless to say, the perpetrators of these schemes frequently folded their tents and crept away, leaving the "investor" holding the bag. A much needed amendment now exempts short-term paper with a maximum yield of eight per cent which "shall not be secured by lien on real or tangible personal property."³⁴

Similarly, the sale of long-term secured notes or bonds was exempt where such notes or bonds were sold to not more than 20 purchasers and the total face amount of all notes or bonds secured by a single mortgage did not exceed \$10,000. Sellers of such paper could avoid registration by limiting their offerings as stated above and then selling successive packages

33. LOSS & COWETT, *BLUE SKY LAW* 45 (1958).

34. FLA. STAT. § 517.05(9) (1959).

of the same character free of Commission examination. The amendment prohibits successive filings of this type by any one issuer.³⁵

Other 1959 amendments to the Florida Securities Act: broadened the exemption with respect to securities exchanged for other securities of an issuer;³⁶ made the pre-incorporation exemption applicable to partnerships and trusts;³⁷ added a new "fair, just and equitable" standard for registration by qualification;³⁸ provided that the registration of securities by qualification or notification which have been revoked, denied or withdrawn may not be registered by the simple process of announcement;³⁹ required that applicants for dealer's and salesmen's licenses establish financial responsibility;⁴⁰ broadened procedural requirements with respect to revocation hearings on licenses of dealers and salesmen.⁴¹

A single amendment to the Corporate Code now makes it unnecessary to state in the application for the certificate of incorporation the number of shares which each subscriber agrees to take.⁴²

35. FLA. STAT. § 517.06(8) (1959).

36. FLA. STAT. § 517.06(9) (1959).

37. FLA. STAT. § 517.06(10) (1959).

38. FLA. STAT. § 517.09(7) (1959).

39. FLA. STAT. § 517.091(3) (1959).

40. FLA. STAT. § 517.12(4) (1959).

41. FLA. STAT. § 517.20 (1959).

42. FLA. STAT. § 608.03(2)(i) (1959).