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Chapter 5: Corporations

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CHAPTER 5

Corporations

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§5.1. Sale of stock of corporation: Financial statements and acceleration clauses in agreement. Mergers and sales of businesses are occurring with increasing frequency. Grozier v. Post Publishing Co.,¹ involving the purchase by John Fox of the stock of the Boston Post newspaper, illustrates the importance of points routinely provided for in the purchase agreement.

When things did not go as expected, among the clauses in the purchase agreement which came under close scrutiny were those relating to: (1) the financial statements on which the deal was based having been "prepared in accordance with generally accepted accounting principles consistently followed," and (2) acceleration of the unpaid balance of the purchase price upon failure to make an installment payment when due.

Balance sheet warranty. Mr. Fox argued that there was a breach of warranty because the reserves for contingent liability for severance pay set forth on the balance sheet warranted by the executors were substantially inadequate. These reserves were apparently adequate for the Post as a going concern but grossly inadequate if the Post had been liquidated on the date of the balance sheet. The Supreme Judicial Court reasoned that, since Mr. Fox bought the Post as a "going concern" and the agreement required the balance sheet be prepared in accordance with generally accepted accounting principles consistently followed, this called for a balance sheet reflecting liabilities on a going-concern basis in accordance with the Post's usual accounting methods, if those were consistent with generally accepted accounting principles. Accordingly, the Court found no breach of warranty.

Acceleration of balance owing. One of the provisions in the agreement purported to call for automatic acceleration of the balance of the purchase price upon a default in the payment of an installment. An installment was not paid when due. Apparently, the executors neither made any demand for payment nor any explicit election to accelerate the maturity of the unpaid balance. Mr. Fox argued that interest should not be allowed upon the unpaid balance of the

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§5.2. Authority of officer to employ broker to sell business. Another aspect of a sale of a business was litigated in *Bloomberg v. Greylock Broadcasting Co.*¹ In this case, the question of the authority of an officer or agent to bind the corporation arose in the context of whether Mr. Podolsky, the president and also assistant treasurer, a director, manager of the business, and the largest though not the majority stockholder could employ a broker to sell a substantial part of the business.

In its discussion of the point, the Supreme Judicial Court observed that Mr. Podolsky did not have authority, solely by virtue of these positions, or any of them, to sell the business or a substantial part of its assets, or to employ a broker to assist in effecting such a sale.²

² An acceleration clause advancing the maturity of the principal at the option of the holder upon failure of the obligor to meet his instalment obligation has been held to be legally binding. *Cassiani v. Bellino*, 338 Mass. 765, 157 N.E.2d 409, 1959 Ann. Surv. Mass. Law §§6.7 (1959); *A-Z Servicenter, Inc. v. Segall*, 334 Mass. 672, 138 N.E.2d 266, 1957 Ann. Surv. Mass. Law §§4.10, 18.2, 20.2 (1956); *Charlestown Five Cents Savings Bank v. Zeff*, 275 Mass. 409, 176 N.E. 191 (1931). The question as to whether the principal is due without a demand for payment of the accelerated amount was considered in *Cassiani v. Bellino*; the Court, stating it was one of first impression, rendered no opinion, thus leaving the question unanswered.

³ The Court found very persuasive the case of *Peter Fuller Enterprises, Inc. v. Manchester Savings Bank*, 102 N.H. 117, 152 A.2d 179 (1959).

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Rather, either Mr. Podolsky's authority to make such a brokerage contract must rest upon express, direct delegation of such authority, or at least the directors, or a majority of them, must have had knowledge of Mr. Podolsky's actions and approved or ratified them. The approval or ratification could be inferred from the directors' having knowledge of the arrangements and doing nothing to repudiate, and could be by informal action without the minutes of the directors' meetings containing any mention thereof.

The opinion does not discuss to what extent, if any, a corporation would be liable for a broker's commission in a reasonable amount merely because the corporation sold its assets by reason of the services of the broker, irrespective of director knowledge or approval of the arrangement with the broker. Nor does the opinion circumscribe the extent to which a majority of the directors by informal action can authorize the sale, or at least the brokerage arrangement for the sale, of a substantial part of the corporation's assets. The requirements in G.L., c. 156, §42, for at least a two-thirds stockholders' vote for a sale by a corporation of all of its property and assets, including its good will, might well cut across any such attempt by a majority of the directors. Perhaps the Court had in mind merely that if a sale of all or substantially all of the assets of a corporation was authorized by the stockholders, the corporation could not be relieved of liability for a

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Mass. 531, 28 N.E.2d 1005 (1940) (president and treasurer, merely as holders of such offices, have little or no inherent power to bind corporation outside of a comparatively narrow circle of functions especially pertaining to such offices); Stoneman v. Fox Film Corp., 295 Mass. 419, 4 N.E.2d 63 (1936) (president and general manager, without more, are restricted to doing those things which are usual and necessary in the ordinary course of corporate business, and have no greater authority by virtue of being an owner of a majority of the stock); Horowitz v. State Street Trust Co., 283 Mass. 53, 186 N.E. 74 (1933) (a person by virtue of his office either as president or as general manager of a corporation has no authority to sell mills); Horowitz v. S. Slater & Sons, Inc., 265 Mass. 143, 164 N.E. 72 (1928) (president or general manager has no power to arrange for the sale of a corporation without authority, expressly or impliedly, conferred by the board of directors).

Although the Court did not specify who could so delegate, the implication would seem to be that such delegation would be by the directors of the corporation.

Connelly v. S. Slater & Sons, Inc., 265 Mass. 155, 164 N.E. 77 (1928) (denying relief to a broker who allegedly arranged the sale of certain mills on the ground that there was no showing of a ratification by the board of directors). See also Kelly v. Citizens Finance Co. of Lowell, 306 Mass. 531, 28 N.E.2d 1005 (1940).

Kagan v. Levenson, 334 Mass. 100, 134 N.E.2d 415 (1956) (execution of mortgage by president and treasurer with knowledge and concurrence of directors, or with their subsequent and long-continued acquiescence, may properly be regarded as act of the corporation, even without vote of the company); Banca Italiana Di Sconto v. Columbia Counter Co., 252 Mass. 552, 148 N.E. 105 (1925) (unnecessary that ratification of president's and assistant treasurer's execution and delivery of note should be by formal vote if corporation knew of such act and assented thereto).

In Connelly v. S. Slater & Sons, Inc., 265 Mass. 155, 164 N.E. 77 (1928), evidence tending to show that the services of the broker were an efficient cause of the sale was excluded on the ground that there was nothing in the by-laws to show that the officers had any authority on behalf of the corporation to employ the broker.

§5.3. Application of "resulting trust" doctrine to dispute on stock ownership between principal stockholders. *Hanrihan v. Hanrihan*, involving a dispute between brothers regarding ownership of common stock of the Albany Carpet Cleaning Company, presents an interesting application of the "resulting trust" doctrine in the corporate field. By the intestate deaths of their father and mother, six children inherited the ownership of the carpet cleaning business. Preferred stock was issued to four of the children, the other two sons, who operated the business, receiving common stock. Differences between the two brothers as to who should have control of the corporation were settled in 1924 by an understanding that the older brother, John, was to have $52\frac{1}{2}$ percent and his brother, Edmund, $47\frac{1}{2}$ percent of the common stock. The shares representing the additional 5 percent held by John were to be voted by the board of directors, and when back pay owing to John had been made up, the 5 percent was to be equally divided between John and Edmund. In 1927, the back compensation due John was paid. John and Edmund continued to run the business on an equal basis, with respect to both authority and salary. In 1949, John refused to turn over to Edmund the shares representing one half of the 5 percent. Attempts to negotiate the differences failed, and Edmund commenced suit in 1951.

The Supreme Judicial Court concluded from the facts that the transaction was in the nature of a "resulting trust," in that shares representing one half of the 5 percent interest were, in essence, held by John for the ultimate benefit of Edmund and therefore were impressed with a trust in favor of Edmund. Once so concluding, the otherwise difficult obstacles presented by the statute of limitations, laches, and the statute of frauds were relatively easily resolved in favor of the "beneficiary." The statute of limitations does not start to run on "resulting trusts" until a repudiation by the trustee. The beneficiary is not guilty of laches if he acts with reasonable promptness thereafter. The intervening two years between the repudiation and the commencement of suit in this case were involved in negotiations to attempt to settle the differences. The statute of frauds requiring a writing has no application to "resulting trusts." Hence many things are possible if the Court can be persuaded that the facts of the situation warrant the application of the "resulting trust" doctrine.

2 Apparently this was the first time that Edmund had requested such shares, and hence the first refusal by John to assign them to Edmund.
3 In *Brady v. Brady*, 238 Mass. 302, 130 N.E. 677 (1921), after their mother's death, two brothers, each owning a four-ninths interest in her realty, borrowed money on the security of the realty with which to settle the estate and purchase the interest of an absentee brother, it being understood that the brother who received the money should account to the other for any portion of the loan not expended and convey to him a one-half interest in the realty. A resulting trust arose in favor of the
§5.4. Use of confidential information by former employee. It is well recognized that one cannot use trade secrets of a former employer without his consent. It is equally well settled that, at least where there is no express contract, the former employee may use his general skill or knowledge in competition with his former employer. But questions exist when there is no written employment contract and the employee uses in competition against his former employer confidential information not involving new or secret inventions or processes or knowledge of special circumstances. This issue arose in New England Overall Co. v. Woltmann.

From the facts in the Woltmann case, use of such confidential information by former employees was in blatant disregard of their understanding with New England Overall. Since its organization in 1903, New England Overall had always safeguarded with the utmost secrecy all information concerning its internal business, especially the names, addresses, requirements, and credit standing of its customers, the identity of and dealings with its suppliers, its costs, and the styles for the approaching season. Furthermore, it was apparently "a general custom in the industry that salesmen were not to reveal or use information acquired during their employment to the detriment of their employers."

While still in the employ of New England Overall, the defendant Woltmann (sales manager) and the defendant Richman (salesman for the New York state territory) engaged in extensive double-dealings to the detriment of New England Overall. The sales manager bought in his own name from suppliers of New England Overall merchandise that was of the same design as that planned by New England Overall for the following year, with the object of selling it to New England Overall's customers before it had disclosed the spring and summer line to its own salesmen. Subsequently, the defendants and one Nahass organized a corporation to compete with New England Overall. The

other brother who, in substance, paid one half the consideration for the deeds, against the brother who received the realty and money.

In Magee v. Magee, 233 Mass. 341, 123 N.E. 673 (1919), a resulting trust was held created for a plaintiff furnishing part of the consideration for a conveyance to his brother and another.


2 Such as there are in cases involving a sale of a business where the seller agrees not to compete. Metropolitan Ice Co. v. Ducas, 291 Mass. 403, 196 N.E. 856 (1935) (agreement made by seller of ice business which is designed to prevent seller from competing in that business with buyer is valid); Boston & Suburban Laundry Co. v. O'Reilly, 253 Mass. 94, 148 N.E. 373 (1925) (limitation in contract of driver not to solicit laundry work or interfere with employer's customers in named cities held valid).


defendants personally ordered merchandise for their new corporation from New England Overall's suppliers for shipment to their new corporation. In the following month, the defendants for the first time informed New England Overall that they planned to go into business together. Thereafter, New England Overall discovered many other instances of double-dealing, such as the defendants having taken confidential items and listings relating to customers and suppliers and using them to solicit both customers and suppliers of New England Overall. The defendants had obtained from the suppliers merchandise of a manufacture, style, and pattern that could not be distinguished from that sold by New England Overall without careful examination, and were selling it at cut prices that tended to destroy New England Overall's trade reputation and good will established over many years.

The defendants contended that the granting of injunctive relief to protect New England Overall's confidential information in the absence of an express contract between them and New England Overall should be limited to situations involving new and secret inventions and processes or knowledge of special circumstances.

In rejecting this argument, the Court distinguished Woolley's Laundry, Inc. v. Silva, on the ground that the list of customers in the circumstances of the Woolley's Laundry case was not confidential. Out of the employer-employee relationship, certain obligations arise, including the obligation not to use in competition with the employer confidential information such as customer lists, etc., of the employer. On the public interest aspects, the Court felt that the public policy against unreasonably restraining freedom of employment and the growth of monopolistic business would not be adversely affected by granting injunctive relief to New England Overall in this case.

Although not expressly set forth in the opinion, the implication seems clear that an important element in determining whether the former employee may use information obtained from his employment with his former employer depends upon whether the former employer had treated such information as confidential even though not involving special knowledge or new or secret inventions or processes.

§5.5. Business organization: Business trust or partnership. Massachusetts business trusts for many years have been used as a vehicle for conducting business enterprises. Interest in these trusts was consid-

6 304 Mass. 383, 23 N.E.2d 899 (1939), in which names of customers of the laundry business committed to employees' memory were considered not confidential. However, in Aronson v. Orlov, 228 Mass. 1, 116 N.E. 951 (1917), the Court enjoined interference with a manufacturer's right to his own trade secret, namely, a method of manufacturing petticoats.


§5.5. 1 In Massachusetts, the business trust was developed mainly for the purpose of holding, handling, and dealing in real estate.
erably heightened by the enactment in early 1961 of a federal law giving special tax advantages to real estate investment trusts.\(^2\) In general terms, to receive favorable treatment there must, among other things, be an unincorporated association or trust, managed by trustees, with transferable shares or certificates of beneficial interest.

Since such trusts are not created pursuant to any statute, as are corporations,\(^3\) it is necessary to turn initially to case law for possible answers to many fundamental questions. Will, for example, the organization created by the trust instrument be treated as a separate legal entity with limited liability for the shareholders, or instead be treated as a partnership, with the "shareholders" being personally responsible for all obligations, as in the case of partners?\(^4\)

This question arose in *Ryder's Case*\(^5\) in the context of whether the claimant was an employee of a business trust and hence entitled to workmen's compensation, or a partner and hence not recognized as an "employee" within the meaning of the workmen's compensation statute.\(^6\) In the Supreme Judicial Court's view, a declaration of trust of the type under consideration created a partnership (at least for purposes of whether the claimant was an "employee" under the workmen's compensation statute) because of the power of the beneficiaries to take charge of the affairs of the organization at any time.\(^7\) The claimant, his son, and the son's wife were the sole beneficiaries, with the claimant and his son the trustees. The beneficiaries could apparently "alter, change or amend the terms and conditions" of the trust at any time.\(^8\)

Prior to the creation of the putative trust, the claimant had been employed as a carpenter by his son. After the organization of the trust, the claimant's son was employed as a carpenter by the business trust created by the instrument which the claimant had executed as a trustee. The claimant was also involved in the work of the business trust, visiting the site of the construction in which his son was employed and discussing issues related to the work with his son.


\(^3\) Trustees of an association not owning or controlling a public utility are merely required to file a copy of the written instrument or declaration of trust creating the trust with the Commissioner and with the clerk of every city or town where such association carries on its business. G.L., c. 182, §2. The extent of regulation of a business trust contrasts sharply with the detailed regulation of a corporation. Id., c. 156.

\(^4\) A limited partner, however, will not become liable as a general partner unless, in addition to the exercise of his rights and powers as a limited partner, he takes part in the control of the business. G.L., c. 109, §1. See Plasteel Products Corp. v. Eisenberg, 170 F. Supp. 100 (D. Mass. 1959), aff'd, 271 F.2d 554 (1st Cir. 1959).

\(^5\) *341 Mass. 661, 171 N.E.2d 475* (1961), also noted in §17.5 infra.

\(^6\) "Employee," every person in the service of another under any contract of hire . . . " G.L., c. 152, §1(4).

\(^7\) In Flint v. Codman, 247 Mass. 463, 142 N.E. 265 (1924), in a declaration creating a real estate trust, the holders of a majority of the entire number of shares were given power to alter or amend the agreement as they deemed fit. The Court held that the arrangement constituted by the declaration was a partnership among the shareholders. In Frost v. Thompson, 219 Mass. 360, 160 N.E. 1009 (1914), the declaration of trust and by-laws provided that the shareholders should have power to remove all of the trustees at any time without cause, to fill any vacancies, to terminate the trust, and other similar broad powers. The voluntary association was held to be a partnership and not a trust.

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The claimant continued to work in the same capacity, for which he was paid a weekly wage of $50, taking orders from his son and not participating in the management of the business.

The fact that appeared to be determinative with the Court was that the claimant as both a trustee and a beneficiary had the same sort of power he would have in an ordinary partnership. The claimant had all of the powers of management that his son had, although in fact he worked under the direction of his son. The Court noted but did not comment on the fact that the trust was not one with transferable shares subject to G.L., c. 182.10

Unless the theory of this case is limited to questions under the workmen's compensation statute,11 the implications of the case cast doubt upon many business trusts conducted as closely held businesses. In a closely held corporation, as is well known, often the officers, directors, and stockholders are the sole parties in interest. Yet a person with such an interest would presumably not be ineligible under the workmen's compensation statute merely for that reason. Why a business trust should be treated differently is not considered in the Ryder's Case opinion.

§5.6. Charitable corporation: Immunity not lost by incidental activities. As is generally known, particularly in the Boston area, the Boston Symphony Orchestra is a very active organization. Among its activities are the summer music programs at Tanglewood, which includes the Berkshire Music Center, a school for music students.

As musical director for the Voice of America, the plaintiff in Boxer v. Boston Symphony Orchestra, Inc.1 wished to broadcast and record student programs at the Music Center. During the course of this work, the plaintiff was injured.

In reaffirming the judicial doctrine of immunity of a public charity from liability for acts of its representatives,2 the Court took occasion to note that, whatever the earlier status of music in the United States might have been, the musical activities of the Boston Symphony are charitable. For purposes of this case, the Court considered it unimportant whether certain things done by the Boston Symphony, such as occasional broadcasting with a commercial sponsor and the making of records producing substantial royalties, may be outside the charitable

9 341 Mass. at 662, 171 N.E.2d at 475.
10 See note 3 supra.
11 There does not appear to be any substantive reason for making such a distinction.

2 The Court, quoting language in Simpson v. Truesdale Hospital, Inc., 338 Mass. 787, 787-788, 154 N.E.2d 357, 358 (1958), stated: "While as an original proposition the doctrine might not commend itself to us today, it has been firmly imbedded in our law . . . and we think that its 'termination should be at legislative rather than at judicial hands.' 

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exemption. The activities of the Berkshire Music Center, in the course of which the plaintiff was injured, are primarily educational.

§5.7. Derivative stockholders' suit: Counsel fees. Not of least interest in derivative suits are the fees to be awarded to counsel for the minority stockholders bringing the action. One of the questions that may arise on the matter of these fees concerns service by counsel prior to his commencement of suit upon behalf of the minority stockholders. Another question is whether the fee should be based upon what the minority stockholder receives or upon the full amount of the corporate recovery. These points, together with the question of when the fee is to be paid when the recovery is to be paid in instalments, were included in the discussion of counsel fees in *In re Pomerantz.* The principle applied on the issue of counsel services before the commencement of the suit was whether the actions of counsel were the efficient cause of ante litem benefits to the stockholders of the corporation.

In the *Pomerantz* case, the federal district court also noted that among the factors to be considered in the award of counsel fees in such cases is the full amount of the corporate recovery (and not merely the benefits flowing only to the petitioning minority stockholders) and the contingent nature of the recovery. In this case, in which the recovery was to be paid to the corporation in instalments, the payment of fees to the plaintiff's attorney were to be a proportionate part of each instalment payment.

§5.8. Private antitrust suit: Service of process on foreign corporation's independent contractor. Generally, service of process upon a party whose relationship is that of an independent contractor of the defendant would be considered improper. However, the Massachusetts Federal District Court in *Kenmore-Louis Theater, Inc. v. Sack,* found in keeping with the increasing liberality of the courts in such jurisdictional cases, that the independent contractor was acting as an agent for the defendant, at least to the extent that the agent was solicit-

3 In Reavey v. Guild of St. Agnes, 284 Mass. 300, 187 N.E. 557 (1933), it was held that a charitable corporation is liable for negligence in the course of activities incidental to corporate power but primarily commercial in character, although carried on to obtain revenue to be used for charitable purposes. See also *Holder v. Massachusetts Horticultural Society, 211 Mass. 370, 97 N.E. 630* (1912).

§5.7. 1 186 F. Supp. 412 (D. Mass. 1960), involving part of the litigation having to do with minority stockholder suits against Bernard Goldfine regarding the East Boston Company.


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ing orders for the distribution of a motion picture that apparently was a subject matter — in part, at least — of the private antitrust suit. Hence the court concluded the defendant was doing business in Massachusetts sufficient to make the service of process proper.

Although not discussed in the opinion, it is difficult to see how the activities of the independent contractor in this case, engaged in soliciting for producers rentals of motion pictures, are in essence different from any independent contractor, such as a manufacturer’s representative, engaged in sales efforts regarding products of companies whom he represents. The state and federal courts in Massachusetts, following the theory of Kenmore-Louis Theater and similar cases,4 may have jurisdiction over many non-Massachusetts concerns whose only contact with Massachusetts is having in Massachusetts an independent contractor engaged in soliciting the sale of products of the foreign concern. This should be distinguished from the independent contractor who buys and then sells for his own account.

§5.9. Statutory simplification of incorporation procedure. Chapter 97 of the Acts of 1961 streamlines incorporation procedure by eliminating the necessity for submitting to the Commissioner of Corporations and Taxation the record of the first meeting of incorporators, including the by-laws. The new statute provides, instead, for a certification in the Articles of Organization that the provisions of law as to the holding of the first meeting of the corporation, the election of officers, and the adoption of by-laws have been complied with, and a certification as to the date of the fiscal year and the annual meeting.

In order that the fiscal year and the date of the annual meeting can be changed without amending the Articles of Organization, Section 2 of Acts of 1961, c. 97, inserts a provision in Section 10 of G.L., c. 156, relative to such information being deemed not part of the Articles of Organization and being amendable merely by filing a certification regarding a change in such dates.