

Appraisal of Stock Where Certain Stockholders Have Dissented-- Basis for Determining Value

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Which of the above three methods, therefore, of dealing with the same problem, would be best suited to cope with the post war construction program, which is bound to bring about an unprecedented resort to the use of contractors' bond agreements?

One may well inquire whether New York should find an advantage in emulating the federal approach to the matter, since, as we have seen, the right of the third party beneficiary may stand or fall dependent on the attitude of the state in the matter. It is apparent that an immediate benefit from a statute such as the federal statute is that at all times, the parties know where they stand.

BENJAMIN F. NOLAN.

APPRAISAL OF STOCK WHERE CERTAIN STOCKHOLDERS HAVE DISSENTED—BASIS FOR DETERMINING VALUE

While the management of a corporation is vested in its board of directors,¹ there are some functions over which the directors do not have exclusive power, and in the exercise of which the consent of a number of stockholders must be obtained. These acts, which require the stockholders' assent, are usually acts other than everyday business affairs, and are often termed "extraordinary acts."² They include: issuance of stock to employees,³ voluntary sale of a corporation's property, rights, privileges and franchises,⁴ making changes respecting shares or capital,⁵ merging,⁶ and consolidating.⁷

Where a corporation wishes to effect these results, a problem arises as to those stockholders who object. In order to protect the rights of these dissenting minority shareholders and at the same time allow the bulk of the shareholders to take beneficial action without being hindered by a minority,⁸ the Stock Corporation Law gives them

¹ N. Y. GEN. CORP. LAW § 27; *Manson v. Curtis*, 223 N. Y. 313, 323, 119 N. E. 559, 562 (1918) (as a general rule, the stockholders cannot act in relation to the ordinary business of the corporation, nor can they control the directors in the exercise of the judgment vested in them by virtue of their office); *Pollitz v. Wabash R. R.*, 207 N. Y. 113, 100 N. E. 721 (1912); *Beveridge v. N. Y. E. R. R.*, 112 N. Y. 1, 19 N. E. 489 (1889); *Leslie v. Lorillard*, 110 N. Y. 519, 18 N. E. 363 (1888).

² *Metropolitan Elevated R. R. v. Manhattan Elevated R. R.*, 11 Daly 373, 475 (N. Y. 1884).

³ N. Y. STOCK CORP. LAW § 14.

⁴ N. Y. STOCK CORP. LAW § 20.

⁵ N. Y. STOCK CORP. LAW § 36.

⁶ N. Y. STOCK CORP. LAW § 85.

⁷ N. Y. STOCK CORP. LAW §§ 86, 91.

⁸ "The purpose of section 21 of the Stock Corporation Law was to protect dissenting shareholders, and the process of appraisal was designed to meet two

the right to object and demand payment for their shares and to have the same appraised and paid for in the manner provided, and subject to the conditions imposed by Section 21 of the Stock Corporation Law.⁹ The New York Court of Appeals, in a recent case¹⁰ involving rights of dissenting shareholders where corporations were consolidated, asserted that, "The remedy of appraisal and payment was intended to afford fair and just compensation to the dissenters and at the same time provide the method by which their objections could be fairly composed so as to enable the consolidation to proceed."¹¹

It is now settled beyond doubt that the right of appraisal is absolute and cannot be denied notwithstanding the fact that the shareholder has a negligible amount of shares, which could readily be sold on the open market, or that he is acting in bad faith, so long as there is compliance with the conditions set forth by the legislature.¹² In *Matter of Marcus (Macy & Co.)*¹³ the court sustained the right of the petitioner to an appraisal although she owned 50 shares of common stock out of a total of 1,656,000 common shares issued. In that case, the preferred stockholders had the right to vote only in certain specified instances, and the corporation proposed granting them equal voting rights with the common shareholders. This, the corporation

evils which arose because of limitations upon the powers of majority shareholders to bind the minority to a course of action beyond the powers of the majority, which might well be greatly to the advantage of those engaged in a corporate enterprise. These two evils are well stated in *Matter of Timmis* (200 N. Y. 177 at 181), dealing with an analogous Statute: . . . This legislation was designed to meet the evils pointed out by the courts by enabling a majority of two-thirds to sell if they deemed it was the best policy, and at the same time to protect the minority, if they regarded the sale as opposed to their interests." *Anderson v. International Minerals & Chemical Corp.*, 295 N. Y. 343, 349, 350, 67 N. E. 2d 573, 576 (1946); *BALLANTINE, CORPORATIONS* § 298 (1946).

⁹ N. Y. STOCK CORP. LAW § 21: "In the event that the stockholders of a corporation have taken action pursuant to sections fourteen, twenty, thirty-six, eighty-five, eighty-six or ninety-one and if any stockholder has objected to such action and demanded payment for his stock as provided in section fourteen, section twenty, subdivision nine of section thirty-eight, subdivision seven of section eighty-five, section eighty-seven or section ninety-one, either such stockholder or the corporation may apply upon eight days' notice to the other, within sixty days after such demand, to the supreme court at any special term thereof held in the judicial district in which the office of such corporation is situated, for the appointment of three persons to appraise the value of such stock, and the court shall appoint three such appraisers and designate the time and place of their first meeting, with such directions in regard to their proceedings as shall be deemed proper. . . ."

¹⁰ *Anderson v. International Minerals & Chemical Corp.*, 295 N. Y. 343, 67 N. E. 2d 573 (1946).

¹¹ *Id.* at 350, 67 N. E. 2d at 576, 577.

¹² "Where, as in this instance, the Legislature by precise language has created a right and with equal precision has set forth the procedure by which that right may be availed of, the courts may not limit or enlarge that right or alter that procedure." *Matter of Marcus (Macy & Co.)*, 297 N. Y. 38, 45, 74 N. E. 2d 228, 231 (1947).

¹³ 297 N. Y. 38, 74 N. E. 2d 228 (1947).

could do;¹⁴ but the Stock Corporation Law provides that, where voting rights are abolished or limited, the stockholder has a right to an appraisal.¹⁵ It was held by the court that the petitioner was entitled to invoke the statutory procedure of appraisal regardless of the fact that she had only a few shares,¹⁶ since her voting rights were limited. In such a matter, the court has no discretion.

The right having been established, the question then arises as to the method to be pursued in evaluating the stock. Section 21 of the Stock Corporation Law lays down no rules for determining value. It merely states that the court shall appoint three appraisers, and a few generalities concerning their conduct, and also the fact that the court may confirm, modify or reject the appraisal. In failing to set forth standards whereby the courts and appraisers may be guided in their task, the New York Legislature is not alone.¹⁷ This makes for a great deal of uncertainty and difficulty, especially since the terminology of the statutes does not clearly indicate just what the appraisers are to look for as they proceed in their work.

It is imperative, therefore, that we look to decisional law to see how the courts have treated this problem. Even here, we find a very meager supply of cases. This is probably due to the fact that many shareholders realize that it is often to their advantage to go along with a proposed change. If they persist in their objections and they desire to sell their stock, they find that they may usually do so very easily on the open market with the possibility of realizing a better price than they might get from an appraisal. And, of course, there is eliminated the necessity of having to wait before getting the money for their stock which, if they submitted to appraisal, would mean waiting until the proceeding was concluded and then possibly court litigation.

A leading and oft-cited case is *Matter of Fulton*¹⁸ which was a proceeding to appraise the value of 481 shares of the preferred stock of a corporation under Section 21. All of the stockholders, except petitioner, voted to sell and transfer the corporate assets, including good will, to another corporation. The par value of all of the stock was \$100, and it had never sold above par. The appraisers determined the preferred stock as being worth \$238.15 per share. They arrived at this figure by dividing the total of the surplus and

¹⁴ N. Y. STOCK CORP. LAW § 36(e).

¹⁵ N. Y. STOCK CORP. LAW § 38, subd. 9(d).

¹⁶ ". . . the Legislature has clearly prescribed the conditions under which a nonconsenting stockholder may have his stock evaluated and enforce payment therefor. We find in those conditions no legislative declaration of a minimum percentage or value of stock which must be owned by a nonconsenting stockholder to qualify him to invoke the prescribed statutory procedure." *Matter of Marcus (Macy & Co.)*, 297 N. Y. 38, 44, 74 N. E. 2d 228, 231 (1947).

¹⁷ See BALLANTINE, CORPORATIONS § 299 (1946); Lattin, *Remedies of Dissenting Stockholders Under Appraisal Statutes*, 45 HARV. L. REV. 233, 243 (1931).

¹⁸ 257 N. Y. 487, 178 N. E. 766 (1931).

capital stock issued, which was \$1,176,957.95, by 4,942, which was the total number of shares issued, common and preferred. The Special Term confirmed the appraisers' report and the Appellate Division affirmed the order. The corporation appealed to the Court of Appeals which, in modifying the order, held that this sale did not constitute a dissolution of the corporation, and that the rule for distribution of surplus between common and preferred stock upon dissolution was not applicable.¹⁹ According to the court, "If the method adopted by the appraisers was correct, it is quite apparent that the respondent, by dissenting and requiring an appraisal of his stock, thereby more than doubled the value of his stock which had never sold for more than par."²⁰ It is obvious that, by utilizing the standards which the appraisers did, a greatly increased value was given to the petitioner's stock, working an injustice upon the holders of the remaining stock.

The court refused to propose any definite criteria for estimating the value of stock, alleging that this must be based on equitable considerations. Rigid general rules, it was felt, would be unwieldy, impractical, and sometimes iniquitous. The object is to see that a dissenting stockholder is not made to lose because of his disagreement with the majority; and, yet, it is necessary to protect the corporation from having to pay fantastic sums for a dissenter's stock. The court states that, "No rule can be laid down for determining the actual or true value of stock of a given class except one of a very general nature and which may, in a particular case, be inapplicable because of varying provisions contained in the charter or by-laws of the corporation or because of the existence of a state of facts peculiar to the situation involved in the particular case."²¹

Of all the factors which are to be considered, the one upon which the greatest reliance should be placed is market price. The utterance of the court in the instant case is that this is what should be paid, except where the stock lacks a fair market price, and has only a "fictitious" one. But, as is indicated by the court, complete dependence should not be placed on a market price which is unreal. It is possible that, because of the proposed sale, the market quotations may show an increased value, and, it not being desired that the dissenting stockholders benefit by such enhanced value, it is said that, "Market quotations are, therefore, to be considered only in so far as they reflect a reasonable basis for estimating market quotations which would probably have continued if a sale had not been made."²² Looking

¹⁹ "The method adopted by the appraisers was the method approved for the appraisal of preferred stock after a dissolution of a corporation. . . ." *Id.* at 491, 178 N. E. at 767.

²⁰ *Ibid.*

²¹ *Id.* at 494, 178 N. E. at 769.

²² "The appraisers should consider the elements that tend to affect market quotations: the rate of dividends; the regularity with which they have been paid; the management and reputation of the company; its prospects for the

at the situation realistically, though, where the market quotations have been artificially enhanced, a stockholder would usually rather sell it on the open market than resort to an appraisal. But there are instances where the directors have so managed the business that the stock has a very much depleted market value. In such cases a dissenting stockholder would rather choose an appraisal in order to recover the actual value of his stock. Here, there was no established market for the petitioner's preferred stock and it was thus necessary to determine actual value, it finally being concluded that in such case the stockholder was entitled to an aliquot part of the capital stock account.²³ The preferred stock was found not to be entitled to share in the surplus.

While mentioning other elements which would have some influence on the final determination,²⁴ the court is reluctant to state particular circumstances which may exert an influence upon the appraisers. It leaves the determination as to the weight which should be given the various factors, up to the discretion of the appraisers. Thus, since the appraisers need not adhere to any set formula, the outcome of an appraisal proceeding cannot be ascertained in advance with any degree of certainty. With the wide range of discretion exercised by the appraisers, a stockholder's attempt to determine by which method—sale on the open market or appraisal—he would receive the best possible price, would be venturing into the realm of prognostication.

Application of Behrens,²⁵ a subsequent case, again set forth the market value as being most important. The dissent was to a proposed merger. The petitioner placed great reliance on the net asset value because of the strong financial position of the company, and tried to minimize the market, which was considerably lower. But, though the stock was not listed on any exchange, there was a fairly active over-the-counter market in the preferred stock, and this had some influence on the court's decision. The court grants that there is a wide latitude for judgment in a proceeding such as this, but remarks that it must test the report of the appraisers by "legal stan-

future and all other circumstances which will aid them in estimating the future course of the stock in the market." *Id.* at 493, 178 N. E. at 768.

²³ "The capital stock account was made up of the amount paid for the stock when issued at par, *i.e.*, \$494,200. That amount divided by the number of shares issued equals the value of each share of preferred stock, the value at which it should have been appraised under the facts in this case." *Id.* at 496, 178 N. E. at 769.

²⁴ ". . . the investment value of the stock which is largely determined by the rate of return, the security afforded that the dividends will be regularly paid, the possibility that dividends will be increased or diminished, the selling price of stocks of like character, the amount of preferred stock in comparison with the common stock, the size of the accumulated surplus applicable to the payment of dividends, the record of the corporation and its prospects for the future." *Id.* at 495, 178 N. E. at 769.

²⁵ 61 N. Y. S. 2d 179 (Sup. Ct. 1946), *aff'd w. o.*, 271 App. Div. 1007, 69 N. Y. S. 2d 910 (1st Dep't 1947).

dards." Relying on the *Fulton* case, it states that, "While there is no legal formula which can be enunciated or applied in valuation proceedings, the appraisal remaining a matter of judgment on the facts in each case, . . . the appraisal should take account of market value, investment value, and net asset value."²⁶ However, no one of these is to be absolutely relied upon to the complete exclusion of any of the others.

In determining the weight to be given market value, it would receive great and probably controlling consideration if there were a ". . . wide market on an established exchange under normal conditions. . . ." ²⁷ Where it did not truly and fairly reflect the judgment of those who were actively engaged in buying and selling stock, little weight would be accorded it. Since the appraisal contemplates a continuance of the corporation, appraisers must not view the situation as a winding up or liquidation, so that the value of the stock and net asset value will not always be similar. While the court hesitates to define investment value, it seems to be the attractiveness that the securities would have to prospective dealers of stock. The question as to whether in the instant case the asset or liquidating value could be accepted in view of the force of other considerations, was resolved in the negative, the court holding that, although the market was not such that it could be relied upon completely for valuation purposes, yet it was apparent that ". . . those who were interested and engaged in buying and selling the stock did not attach any value to its approaching net asset value."²⁸ And the conclusion was that the market was entitled to some weight.

One of the clearest expressions of the courts' attitude toward this problem was made by Justice Peck in the recent case of *Matter of Marcus (Macy & Co.)*.²⁹ In this proceeding, to appraise petitioner's stock, the dissenter served the company with a subpoena *duces tecum* requiring it to produce all its books, records and working papers and also those of its subsidiaries. She had included in the order appointing the appraisers a provision that the appraisers should select a certified public accountant to prepare an audit as part of the expenses of the appraisal. The object of this was to inquire into the value of all the underlying assets of the company and its subsidiaries, which operated department stores in New York, New Jersey, Ohio, Georgia and California. The issue raised was whether it was proper to allow the petitioner a physical inventory of all the goods or whether it was sufficient to use market value of the stock or make a valuation

²⁶ *Id.* at 182.

²⁷ *Id.* at 183.

²⁸ *Id.* at 184.

²⁹ 273 App. Div. 725, 79 N. Y. S. 2d 76 (1st Dep't 1948). *Matter of Marcus*, note 13 *supra*, concerned the question of whether petitioner had a right to an appraisal. The instant case involved the proceeding itself, and the objection by the corporation to some of the methods the stockholder wished to employ in the appraisal proceeding.

based on known factors, *e.g.*, market value, book value, earnings, dividends and business conditions, without an inventory and audit. The company's motion to vacate the subpoena *duces tecum* was granted and an order appointing appraisers was modified, so that the provision for the selection of an accountant was eliminated. The court held that in determining value, the market value controlled where the market for stock was free and fair and that net asset value was not the proper standard for determining the value of shares of a going concern.

Here again the court emphasizes that the facts of each case must be viewed separately in order to ascertain the various factors to be considered in evaluating stock, and also the weight to be given to each. Although it does not attempt to minimize other factors, the court lays great stress on market value stating that it ". . . is the controlling consideration where there is a free and open market and the volume of transactions and conditions make the market a fair reflection of the judgment of the buying and selling public."³⁰ It observes that, wherever other factors have been given greater weight it has been because the market was very narrow and unestablished so that it could not be accepted as authoritative. The market, in the instant case, was a very active one, several hundred shares being traded every day. In a typical six-months period there were no significant changes nor erratic fluctuations which would warrant calling the market anything but normal. The market, having been found to be sufficiently representative of the opinion of those interested in the sale and purchase of the stock, the court is led to the conclusion that it should be accorded full recognition.

The company, in accordance with accepted and sound accounting practice, carried its fixed assets at cost and its inventories at the lower of cost or market. The petitioner contended that, in the light of the inflationary conditions existing at that time, the company may have undervalued its assets, thus resulting in inaccurate market valuations, since the corporation's statements affected, to a great extent, the market prices of the stock. The court dismissed this contention stating that the "inflationary conditions" were common knowledge and allowance was made for these by those most familiar with the market. It could not be held as a matter of law that the company's valuation of its assets in its published statements was conclusive; yet ". . . market traders and investors were as fully and accurately informed as to the condition of the company as is customary through financial statements."³¹ It should be noted, in support of the court's argument, that on the appraisal date, Macy stock had been selling in the market at 60% above the book value. It is apparent from this that the traders had made a very liberal allowance for values over and above book values. It may very well be that asset values are in fact

³⁰ *Id.* at 727, 79 N. Y. S. 2d at 78.

³¹ *Id.* at 730, 79 N. Y. S. 2d at 80.

higher at a particular time than the figures at which they are carried. Nevertheless, for stock appraisal purposes, this is relatively insignificant since the stock must be appraised not as if it were a liquidation proceeding, but as the stock of a going concern. Thus it would not be necessary to produce the company's books and have an inventory taken, and net asset value would be given little or no consideration. Even if it were to be given some consideration, a detailed revaluation of assets would be unwarranted, as it does not appear that by pursuing that course there would be any closer realization of true value than the judgment of those who daily trade on the exchange.

The *Marcus* case is a very practical approach to the problem, and is a good indication as to how far one will be allowed to go in examining corporate books. The appraisal proceeding is to see that the stockholder gets fair value for his stock,³² and it was not intended to permit abuse by opening the gates to every whim and desire of the dissenting stockholders. An appraisal proceeding should be reasonable, and any deviation would be a subversion of the intent of the statute. While the case does not stand for the proposition that where stock is listed on the exchange, the exchange quotation must be the figure used as the value of the stock; yet, if it can be shown that it reflects the value of the stock as accurately, objectively and fairly as possible, it should be accorded the greatest consideration. Market quotations are only one of the factors to be considered, and the appraisers will not be confined to that alone. Detailed checking of fixed assets and inventory valuation should not be allowed unless it can be shown that there was some wrongful manipulation of the books, making the market value inaccurate and undependable. That this is sound is evident. A contrary policy would most certainly be detrimental to any semblance of order in business. A mere dissenter could disrupt the smooth functioning of a large organization, involving it in taking numerous inventories and having its books frequently in the hands of auditors and appraisers. Any progress attempted by a corporation would be stymied, and it would probably refrain from making desirable changes, when it foresees the ominous consequences. It would also be fertile ground for what might be called "extortion", the dissenting stockholder being able to mulct the corporation for many times the value of his stock, with the resulting injustice to the corporation, to the other shareholders and possibly the ultimate consumer. The court seems to intimate that petitioner was exerting every effort to get an exorbitant price for her interest. From a realistic point of view it can be seen that, by asking for \$20,000 for stock

³² "The administration of an appraisal proceeding is to be kept to its statutory purpose of protecting a dissenting stockholder's legitimate interests. Consistent with that purpose, the legitimate interests of the company and its other stockholders should be protected by keeping the proceedings within reasonable bounds and avoiding all unnecessary expense and burden upon the parties." *Id.* at 729, 79 N. Y. S. 2d at 80.

reasonably worth \$2,000, petitioner's conduct is such that the court was justified in doubting her motives. Out of 1,650,000 outstanding shares, she alone, with a mere 50 shares, objected to the corporate action and asked for an appraisal. She could have received a very handsome sum by selling on the open market, which sum, while not ten times the value of her stock, would nevertheless have given her more than a reasonable return on her investment. And, while it is settled that the number of shares held or the good faith of the shareholder is irrelevant, still ". . . the court is not required to blind itself to reality and permit the proceeding to go beyond what is necessary to award petitioner fair value for her stock and become a device for obtaining more than fair value."³³

While the *Marcus* case was decided in a very practical and realistic manner, it could just as well have gone the other way, there being no set channels to guide or limit the appraisers and judges. Though market value has been emphasized continuously throughout the cases, a problem arises when there is no listing on an exchange or any transactions on the open market. A question also arises whether the courts might not take a contrary view to that taken in the *Marcus* case if the dissenting stockholder owned, instead of 50 shares, 500,000 shares, or some other figure. While the controversies arising on the subject are not many, still it appears that the legislature should set forth certain general standards which would aid immeasurably in clarifying the situation, and it is submitted that Stock Corporation Law, Section 21, be amended to accomplish this result.

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THE STATUS OF AN ACCOMMODATION INDORSER UNDER SECTION 29 OF THE UNIFORM NEGOTIABLE INSTRUMENTS LAW

Since the adoption of the Uniform Negotiable Instruments Law in 1896 by the Commissioners on Uniform State Laws in National Conference and its subsequent enactment by all the states, one of its provisions, Section 29,¹ has been the subject of much criticism;² and the source of litigation, much of which is concentrated upon the

³³ *Id.* at 729, 79 N. Y. S. 2d at 80.

¹ N. Y. NEGOTIABLE INSTRUMENTS LAW § 55. "An accommodation party is one who has signed the instrument as maker, drawer, acceptor, or indorser, without receiving value therefor, and for the purpose of lending his name to some other person. Such a person is liable on the instrument to a holder for value, notwithstanding such holder at the time of taking the instrument knew him to be only an accommodation party."

² Ames, *The Negotiable Instruments Law*, 14 HARV. L. REV. 241, 242 (1900); Brannon, *Some Necessary Amendments of the Negotiable Instruments Law*, 26 HARV. L. REV. 493, 494 (1913); Brewster, *Proposed Amend-*