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Private Corporations--Declaration of Dividends--Source--Good-Will--Unrealized Appreciation (Randall, as Trustee, etc. v. Bailey, et al., 23 N.Y.S.2d 173 (1940))

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causation or of negligence even though it does not negative the existence of remote possibilities.[11]

R. E. B.

PRIVATE CORPORATIONS—DECLARATION OF DIVIDENDS—SOURCE—GOOD-WILL—UNREALIZED APPRECIATION.—Plaintiff, as Trustee in Bankruptcy of the Bush Terminal Company, brings this action against former directors of the corporation to recover on its behalf the amount of cash dividends declared and distributed during the years 1928–1932 aggregating $3,639,058.06. The defendant directors are sought to be held personally liable under Section 58[1] of the Stock Corporation Law, as it existed when the dividends here involved were declared and paid. Plaintiff claims: that, although the company's books showed a surplus at the times of the declarations and payments, there was in fact no surplus; and that the capital was actually impaired by the full amount of each of the dividends declared in violation of Section 58. In 1902 defendant Irving T. Bush controlled the Bush Company, Ltd. which was engaged in a going terminal enterprise on the Brooklyn waterfront. This company owned warehouses, piers and railroad facilities. During this year the Bush Terminal Company was formed, and Mr. Bush entered into a contract with the newly formed company; pursuant to which it issued to Mr. Bush $2,000,000 in bonds and $3,000,000 in par value common stock and received, in addition to certain services of Mr. Bush, a large tract of industrially improved land contiguous to that owned by the Bush Com-

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[11] Ingersoll v. Liberty Bank of Buffalo, 278 N. Y. 1, 14 N. E. (2d) 828 (1938).

[1] N. Y. STOCK CORP. LAW § 58, as it existed during the period involved here provided as follows: "DIVIDENDS. No stock corporation shall declare or pay any dividend which shall impair its capital or capital stock nor while its capital or capital stock is impaired, . . . unless the *value* of the assets remaining after the payment of such dividend . . . shall be at least equal to the aggregate amount of its debts and liabilities including capital or capital stock as the case may be. In case any such dividend shall be paid . . . the directors in whose administration the same shall have been declared or made, except those who may have caused their dissent therefrom to be entered upon the minutes of the meetings of directors at the time or who were not present when such action was taken shall be liable jointly and severally to such corporation and to the creditors thereof to the full amount of any loss sustained by such corporation or by its creditors respectively by reason of such dividend. . . ." Under this statute, good faith on the part of directors in declaring such dividends was no defense to an action for their recovery. Quintal v. Greenstein, 142 Misc. 854, 256 N. Y. Supp. 462, *aff'd*, 236 App. Div. 719, 257 N. Y. Supp. 1034 (1st Dept. 1932). By N. Y. Laws 1939, c. 364, §§ 1, 2, § 58 was amended so as to provide a defense to those directors "who affirmatively show that they had reasonable grounds to believe, and did believe, that such dividend . . . would not impair the capital of such corporation." This amendment was expressly made inapplicable to dividends declared and paid prior to its enactment, hence it does not affect the instant case.

pany, Ltd. and a lease by the latter of certain other lands. The $3,000,000 of common stock was not entered on the books of the newly formed corporation until 1905 when for the first time there appeared on the books of account a corresponding asset account labeled "Good-Will". The $3,000,000 "good-will" item continued to appear on the books from 1905 until this action was brought. It was not challenged until this action. The company's land was carried on its books at *cost* until 1915. In that year, it was written up to 80% of its assessed valuation, and in 1918 it was further written up to the exact amount at which it was assessed. The result of these write-ups constituted a net appreciation in the fixed assets account of $7,211,-791.72, so that during the period in question the land was carried on the books at $8,737,949.02, whereas its actual cost was $1,526,157.30. In computing the amount of surplus during the years 1928–1932 plaintiff contended: that (1) it was improper to include as an asset the good-will item of $3,000,000; (2) the "write-up" of land values in the amount of $7,211,791.72 over cost carried on the books reflected merely unrealized appreciation in the value of such land. *Held,* in favor of defendants. *Randall, as Trustee, etc.* v. *Bailey, et al.,* 23 N. Y. S. (2d) 173 (1940).

Good-will [2] is presumptively an asset which must be accounted for and may be sold like any other asset upon liquidation of a business.[3] The chief elements of value upon any sale of good-will are: (a) continuity of place; (b) continuity of name, and in an enterprise of a complex nature the further element of continuity of organization is reflected in its value.[4] As property, it is peculiarly within the province of directors to fix its value, and in the absence of fraud the judgment of directors as to its value is conclusive.[5] In the instant case, the $3,000,000 good-will item remained on the books for about thirty-five years including the period in question; during which time the enterprise expanded and flourished, and its profits continuously increased. In spite of a long corporate history of prosperity this item remained constant. No fraud, bad faith, or abuse of discretion was shown on the part of the directors in evaluating the good-will in 1905.[6] The defendants, therefore, were justified in retaining this

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[2] Washburn v. National Wallpaper Co., 81 Fed. 17 (C. C. A. 2d, 1897); People *ex rel.* Johnson Co. v. Roberts, 159 N. Y. 70, 53 N. E. 685 (1899); Von Bremen v. MacMonnies, 200 N. Y. 41, 93 N. E. 186 (1910); *In re* Stevens, 46 Misc. 623, 95 N. Y. Supp. 297 (1905); 28 C. J. (1922) § 1.

[3] Matter of Brown, 242 N. Y. 1, 150 N. E. 581 (1926).

[4] People *ex rel.* Johnson Co. v. Roberts, 159 N. Y. 70, 53 N. E. 685 (1899); Matter of Brown, 242 N. Y. 1, 150 N. E. 581 (1926).

[5] N. Y. STOCK CORP. LAW § 69 (". . . Any Corporation may purchase any property . . . necessary for the use and lawful purposes of such corporation, and may issue stock to the amount of the value thereof in payment therefor, . . . and in the absence of fraud in the transaction the judgment of the directors as to the value of the property purchased shall be conclusive. . . ."); Estate Planning Corp. v. Commissioner of Internal Revenue, 101 F. (2d) 15 (C. C. A. 2d, 1939).

[6] Omaha v. Omaha Water Co., 218 U. S. 180, 30 Sup. Ct. 615 (1910); Des

item on the books from 1928 to 1932, for they acted within the bounds of reason and discretion.[7]

With respect to unrealized appreciation, the question whether dividends can be declared therefrom depends largely upon the history and the construction of the statute.[8] The earliest provisions relating to duties and liabilities of directors in regard to dividends made it unlawful to declare dividends "excepting from the surplus profits arising from the business" or to "divide, withdraw or in any way pay to the stockholders or any of them, any part of the capital stock".[9] These statutes were repealed in 1890, and then for the first time there appeared a sentence defining impairment of capital stock.[10] In 1892[11] and 1901[12] the amendments made in 1890[13] were again repealed, and there was a return to the old language of the Revised Statutes. However, in 1923[14] these statutes were again amended and reenacted as Section 58 of the Stock Corporation Law as it existed when the dividends here involved were declared and paid. The history of the statute in question thus manifests a conscious intent on the part of the legislature to get away from the "surplus profits" test as the sole source of dividends and substitute the "value of the assets" test.[15] The later decisions likewise support the view that "value" is the test of impairment.[16] Cost, or book value, is not a true

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Moines Gas Co. v. Des Moines, 238 U. S. 153, 35 Sup. Ct. 811 (1915); Los Angeles Gas and Electric Corp. v. Railroad Commission of California, 289 U. S. 287, 53 Sup. Ct. 637 (1933); Washburn v. National Wallpaper Co., 81 Fed. 17 (C. C. A. 2d, 1897); Thomas v. Sutherland, 52 F. (2d) 592 (C. C. A. 3d, 1931); White, Corbin and Co. v. Jones, 79 App. Div. 373, 79 N. Y. Supp. 583 (4th Dept. 1903).

[7] White, Corbin and Co. v. Jones, 79 App. Div. 373, 79 N. Y. Supp. 583 (4th Dept. 1903).

[8] See note 2, *supra.*

[9] N. Y. Laws 1925, c. 325, § 2; 4 N. Y. REV. STAT. § 2 (1830).

[10] N. Y. Laws 1890, c. 564, § 23 (". . . The capital stock of a stock corporation shall be deemed impaired when the *value* of its property and assets after deducting the amount of its debts and liabilities, shall be less than the amount of its paid up capital stock."). The original phrase, "surplus profits *arising from the business*" was also changed to "surplus profits *of its business.*"

[11] N. Y. Laws 1892, c. 688, § 23. The heading of this section was also changed to read: "Liability of directors for making unauthorized dividends" in lieu of "Liability of directors for dividends not made from surplus profits."

[12] N. Y. Laws 1901, c. 354, § 23.

[13] See notes 10, 11, *supra.*

[14] See note 2, *supra.* The heading of this section was changed to "Dividends" thereby omitting any reference to surplus or surplus profits.

[15] N. Y. PENAL LAW § 664 provided in part that a director ". . . who concurs in any vote, 1.—To make a dividend, except from *surplus profits arising from the business* . . . is guilty of a misdemeanor." By N. Y. Laws 1924, c. 221, this section was amended to read in its present form: ". . . 1.—To make a dividend, except from *surplus*, . . ." This change was probably enacted in order to conform to § 58 of the N. Y. STOCK CORP. LAW.

[16] Bourne v. Bourne, 240 N. Y. 172, 148 N. E. 180 (1925); Small v. Sullivan, 245 N. Y. 343, 157 N. E. 261 (1927) (referring to N. Y. STOCK CORP. LAW § 58, the court said: "The object of the provision was to prevent a withdrawal of the property which would reduce the *value* of the assets below the sum limited for its capital in its charter. When the property of the corporation

test.[17] The surplus account represents the net assets of a corporation in excess of all liabilities including its capital stock. This surplus may be paid-in surplus, earned surplus, or may consist of increases resulting from a revaluation of fixed assets.[18] It is well settled that dividends may be declared from accumulated surplus[19] and from paid-in surplus.[20] With respect to dividends declared from appreciation in the value of assets, such dividends have been held to be taxable as dividends paid.[21] Therefore, if value of the assets, and not cost, is the proper test, and surplus may take the form of unrealized apprecia-

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exceeds that limit, the excess is *surplus* which may be divided among the stockholders."); Irving Trust Co. v. Gunder, 152 Misc. 83, 271 N. Y. Supp. 795 (1934); Gallagher v. Davison, N. Y. L. J., June 13, 1935, p. 3045, col. 7; Gallagher v. New York Dock Co., 19 N. Y. S. (2d) 789 (1940).

[17] Book values of assets or cost alone do not always reflect actual value, but are some evidence of true value. Irving Trust Co. v. Gunder, 152 Misc. 83, 271 N. Y. Supp. 795 (1934). *Value* constitutes the important factor in eminent domain, taxation and public utility rate regulation. Some types of evidence of value which have been held admissible are: (a) *Reproduction cost less depreciation*—Smyth v. Ames, 169 U. S. 466, 18 Sup. Ct. 418 (1898) (public utility rate regulation); Matter of the City of New York (Blackwell's Island Bridge), 198 N. Y. 84, 91 N. E. 278 (1910) (eminent domain); People *ex rel.* New York Dock Co. v. Cantor, 208 App. Div. 52, 203 N. Y. Supp. 424 (2d Dept. 1924) (taxation); (b) *Capitalization of earnings*—Matter of the City of New York (Blackwell's Island Bridge), 198 N. Y. 84, 91 N. E. 278 (1910) (eminent domain); People *ex rel.* Third Avenue R. R. v. State Board of Tax Commissioners, 157 App. Div. 731, 142 N. Y. Supp. 986 (1st Dept. 1913), *aff'd*, 212 N. Y. 472, 106 N. E. 325 (1914) (taxation); People *ex rel.* Lehigh Valley R. R. v. Harris, 168 Misc. 685, 6 N. Y. S. (2d) 794 (1938), *aff'd*, 257 App. Div. 912, 12 N. Y. S. (2d) 1011 (4th Dept. 1939), *aff'd*, 281 N. Y. 786, 24 N. E. (2d) 476 (1939) (taxation); (c) *Market price of stocks and bonds*—State Railroad Tax Cases, 92 U. S. 575 (1875) (involving taxation of the value of a railroad franchise); Bailey v. Megan, 102 F. (2d) 651 (C. C. A. 8th, 1939); (d) *Assessed value*—Heiman v. Bishop, 272 N. Y. 83, 4 N. E. (2d) 944 (1936) (assessed value of property admissible to determine value of real property in proceeding for deficiency judgment under N. Y. CIV. PRAC. ACT § 1083a); Matter of the Board of Water Supply, 277 N. Y. 452, 14 N. E. (2d) 789 (1938) (eminent domain); (e) *Prior recent sales of similar property in the vicinity*—Manhattan Co. v. Premier Building Corp., 247 App. Div. 297, 285 N. Y. Supp. 806 (2d Dept. 1936) (deficiency judgment under N. Y. CIV. PRAC. ACT § 1083a).

[18] Mr. Justice Brandeis in Edwards v. Douglas, 269 U. S. 204, 46 Sup. Ct. 85 (1925).

[19] Dodge v. Ford Motor Co., 204 Mich. 459, 170 N. W. 668 (1919); Kent v. Quicksilver Mining Co., 78 N. Y. 159 (1897); Williams v. Western Union Telegraph Co., 93 N. Y. 162 (1883); Roberts v. Roberts-Wicks Co., 184 N. Y. 257, 77 N. E. 13 (1906).

[20] Equitable Life Assurance Co. v. Union Pacific R. R., 212 N. Y. 360, 106 N. E. 92 (1914).

[21] People *ex rel.* Wedgewood Realty Co. v. Lynch, 262 N. Y. 202, 186 N. E. 673 (1933). In this case the taxpayer later moved to amend the *remittitur* which in effect would omit from surplus any unrealized appreciation in the cost of the value of real estate. In a *per curiam* opinion the motion was denied, 262 N. Y. 644, 188 N. E. 102 (1933). It is submitted that the denial of the motion was at least a tacit approval of the propriety of declaring dividends from unrealized appreciation.

tion, it follows that unrealized appreciation may constitute a proper source from which dividends may be declared.[22]

P. C.

TORTS—NEGLIGENCE OF POLICE OFFICER—MUNICIPAL IMMUNITY LIMITED BY STATUTE—CONSTRUCTION.—Plaintiff's intestate, while lawfully on a public street in New York City, was killed as a result of injuries received when a commandeered automobile, negligently operated by a municipal police officer in the pursuit of suspicious characters who were fleeing from the officer, ran into the decedent and his pushcart. This action was brought against the City of New York and other defendants to recover damages for the death. Trial Term dismissed the plaintiff's complaint against the City of New York. On appeal, *held,* the judgment at Trial Term unanimously affirmed. *Berger* v. *City of New York,* 260 App. Div. 402, 22 N. Y. S. (2d) 1006 (2d Dept. 1940).

No recovery can be had on common law principles against a municipal corporation for the torts of policemen or other municipal appointees whose duties are undertaken in the fulfillment by the municipal corporation of its governmental as distinguished from its corporate functions.[1] The plaintiff-appellant contended that he has a remedy under Section 50-a of the General Municipal Law,[2] which is

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[22] Plaintiff further contended that it was improper not to "write down" to actual value on the company's books the cost of investments in and advances to subsidiaries and thereby fail to take unrealized depreciation into account. Thus, plaintiff took the inconsistent position by arguing that investments and advances must be taken at their actual value, whereas fixed assets are to be considered only at cost. In short, the directors should have taken unrealized depreciation into account, while unrealized appreciation should have been disregarded. The patent inconsistency of this position was resolved by the court by stating: "that the same reasons which show that unrealized appreciation must be considered are equally cogent in showing that unrealized depreciation must be considered. In other words, the test being whether or not the *value* of the assets exceeds the debts and the liability to stockholders, *all* assets must be taken at their *actual value.*" However, although plaintiff's position was correct as to these investments and advances and also with respect to certain demolished properties which should have been written off and not considered in computing the amount of surplus, even if all these deductions claimed by the plaintiff were allowed in full, the actual value of the land and improvements at all times during the period in question exceeded the book value thereof by an amount sufficient to show a surplus greater than the amount of the dividends.

[1] Maximilian v. Mayor, etc., of City of New York, 62 N. Y. 160 (1875); Woodhull v. Mayor, etc., of City of New York, 150 N. Y. 450, 44 N. E. 1038 (1896); Lefrois v. County of Monroe, 162 N. Y. 563, 57 N. E. 185 (1900); Wilcox v. City of Rochester, 190 N. Y. 137, 82 N. E. 1119 (1907); Lacock v. City of Schenectady, 224 App. Div. 512, 231 N. Y. Supp. 379 (3d Dept. 1928); Duren v. City of Binghamton, 172 Misc. 580, 15 N. Y. S. (2d) 518 (1939), *aff'd,* 258 App. Div. 694, 18 N. Y. S. (2d) 518 (3d Dept. 1940).

[2] Formerly N. Y. HIGHWAY LAW § 282-g.