Fordham Law Review

Volume 30 | Issue 3 Article 8

1962

Shareholder Liability for Wages: Section 630 of the New York Business Corporation Law

rule would set to rest the uncertainties and inconsistencies resulting from the *O'Connell* dictum and subsequent case development. It would establish a consistent basis upon which courts might rely though they reach contrary results. For lawyers, it would provide a secure and clear standard of liability in an area of tort liability that is both insecure and unclear. It is argued that the imposition of liability would be greatly heightened for those engaged in the mass media of communication by the imposition of a principle so sweeping and so simple. But correspondingly, so must their sense of responsibility be sharpened.

Because it is basically a rule of interpretation, rather than of mechanical determination, the rule of "ordinary meaning" necessarily leaves a great area of discretion in the hands of the courts. What constitutes the ordinary meaning of a publication? What facts, what innuendoes are to be included within its span? This is the area of discretion in which the courts should take cognizance of literary devices which connote much more than actually appears and of words whose associations may be defamatory. Where the meaning lies concealed through a device of art and where such meaning may be brought to light through a process of intelligent interpretation, the author should not be granted immunity if his meaning is defamatory.

SHAREHOLDER LIABILITY FOR WAGES: SECTION 630 OF THE NEW YORK BUSINESS CORPORATION LAW

New York has never permitted the corporate form of doing business to operate as a complete shield against shareholder liability for the debts of their corporation. Since the first general corporation law was enacted over 150 years ago,[1] New York statutes have in one form or another provided for shareholder liability, a liability which has at times been narrowly construed but at other times liberally and somewhat harshly applied.

The liability originally imposed was at first interpreted to mean limited liability—to the extent of each shareholder's respective shares.[2] Later cases were more generous with corporate creditors and construed the statute to permit the imposition of double liability—an amount equal to twice the subscription price of their stock.[3] The Manufacturing Corporations Act of

1. N.Y. Sess. Laws 1811, ch. 67. Section 7 of the act provided: "[F]or all debts which shall be due and owing by the company at the time of its dissolution, the persons then composing such company shall be individually responsible to the extent of their respective shares of stock in the said company and no further . . . ."

2. "[B]y the 7th section of the Statute, the persons composing the Company, at the time of its dissolution, are individually responsible, to the extent of their respective shares, for the debts then due, and owing, by the Company." Slee v. Bloom, 19 Johns. Ct. Err. 456, 477 (N.Y. Ct. Err. 1822).

3. "Every stockholder in a company of this description, incurs the risk of not only losing the amount of stock subscribed, but is also liable for an equal sum, provided the debts due and owing at the time of dissolution, are of such magnitude as to require it." Briggs v. Penniman, 8 Cow. 387, 392 (N.Y. Ct. Err. 1826). See Howard, Stockholders' Liability Under the New York Act of March 22, 1811, 46 J. Pol. Econ. 499 (1938), which discusses these two cases and their interpretation of the statute.

1848[4] was the first to specifically provide protection for corporate employees. In effect it made shareholders' sureties for the payment of employees' wages.[5] Since 1848 the trend in other states has been toward the elimination of liability in excess of limited or double liability.[6] New York, on the other hand, has retained and expanded this specific liability.[7]

Section 71 of the New York Stock Corporation Law imposes joint and several liability on stockholders for all debts, wages, or salaries due and owing any laborers or employees of the corporation.[8] Wages and salaries include overtime, vacation, and severance pay and employer contributions to welfare or insurance funds.[9] In order to avail himself of the statute the employee must give to the stockholder, whom he elects to hold liable, notice of such fact within thirty days after termination of his employment.[10] The action against the shareholder must then be commenced within thirty days after the return of an unsatisfied judgment against the corporation.[11]

Decisions under Section 71

Section 71 left many problems for judicial resolution. One such question was settled by *Armstrong v. Dyer*.[12] It held that the section did not apply to stockholders of a foreign corporation doing business in New York. There was also the problem of defining the terms laborer, servant, or employee. Who would be included in the class? It has been held that an attorney, even though employed at a fixed salary,[13] a secretary,[14] a major shareholder who was a vice president and director of the corporation,[15] and a bookkeeper paid on a yearly basis[16] were not servants, laborers, or employees within the meaning of the statute. On the other hand, an attorney whose services were directly connected with the corporation,[17] a bookkeeper paid on a

4. N.Y. Sess. Laws 1848, ch. 40.

5. N.Y. Sess. Laws 1848, ch. 40, § 18 provided: "The stockholders of any company organized under the provisions of this act, shall be jointly and severally individually liable for all debts that may be due and owing to all their laborers, servants and apprentices, for services performed for such corporation."

6. Only five other states impose such liability. The various statutory provisions are: Mass. Gen. Laws Ann. ch. 156, § 35 (1959); Mich. Const. art. XII, § 4 and Mich. Comp. Laws § 620.13 (1948); Pa. Stat. Ann. tit. 15, § 2852-514 (1958); Tenn. Code Ann. § 48-710 (1955); Wis. Stat. § 180.40(6) (1957).

7. N.Y. Sess. Laws 1850, ch. 140, §§ 10, 12; N.Y. Sess. Laws 1901, ch. 354, § 54; N.Y. Sess. Laws 1923, ch. 787, § 71; and finally the present N.Y. Stock Corp. Law § 71.

8. N.Y. Stock Corp. Law § 71.

9. Ibid.

10. Ibid.

11. Ibid.

12. 268 N.Y. 671, 198 N.E. 551 (1935).

13. Bristor v. Smith, 158 N.Y. 157, 53 N.E. 42 (1899).

14. Coffin v. Reynolds, 37 N.Y. 640 (1868).

15. Harris v. Lederfine, 196 Misc. 410, 92 N.Y.S.2d 645 (Sup. Ct. 1949).

16. Wakefield v. Fargo, 90 N.Y. 213 (1882).

17. Gurney v. Atlantic & Great W. Ry., 58 N.Y. 358 (1874).

weekly basis,[18] a salesman, even though paid on a commission basis,[19] and a combination research instructor and salesman[20] were within the section. These cases, apparently indistinguishable, have probably been outmoded by the 1952 amendment which set out a broader definition of wages and salaries.[21]

It has also been held that the liability imposed by section 71 was quasi-contractual[22] and that timely service of a summons and complaint on one stockholder tolled the abbreviated statute of limitations as to the other notified stockholders.[23]

The fact that the section was rarely used did not blunt the potential liability which it could impose. In 1952, when section 71 read as it reads today, a New York City newspaper, the New York Compass, ceased publication. It had paid salaries and wages in full to the date of suspension. Within the prescribed period of time, approximately fifteen shareholders of a total of more than 2,300, were notified that they were being charged jointly and severally with claims amounting to $130,000. These claims consisted of lost severance and vacation pay which had not been provided for by the corporation. Some of the shareholders held liable did not know they owned the stock, which, to add to the irony, was then valued at about two dollars per share. Others owned only a single share and many owned less than ten shares. One stockholder, a sympathizer with the paper's cause, had received his shares for his year-end contribution to the newspaper's outstanding debt. Although the claims were eventually settled for some $70,000, the Compass calamity underscored not only the uniqueness of the New York statute but its potential unfairness.[24] Shareholders who were beyond the jurisdiction of New York courts escaped liability.[25] The fifteen Compass

18. Farnum v. Harrison, 167 App. Div. 704, 152 N.Y. Supp. 835 (1st Dep't 1915).

19. Hitchcock v. Pagenstecher, 198 App. Div. 511, 190 N.Y. Supp. 705 (1st Dep't 1921).

20. Evans v. Lawrence Stern & Co., 270 N.Y. 177, 200 N.E. 777 (1936).

21. "For the purpose of this section, wages or salaries shall mean all compensation and benefits payable by an employer to or for the account of the employee for personal services rendered by such employee. These shall specifically include but not be limited to salaries, overtime, vacation, holiday, and severance pay; employer contributions to or payments of insurance or welfare benefits; employer contributions to pension or annuity funds; and other moneys properly due or payable for services rendered by such employee." N.Y. Stock Corp. Law § 71.

22. Halkin v. Hume, 123 Misc. 815, 206 N.Y. Supp. 702 (N.Y.C. Munic. Ct. 1924).

23. Ryan v. Dash, 114 N.Y.S.2d 36 (Sup. Ct. 1952). The employee must not only notify the stockholder within thirty days but must thereafter commence suit within thirty days. The interpretation of this case tolls the second thirty day period as to those shareholders notified within the first thirty day period.

24. See Rogers & McManus, Stockholders' Booby-Trap: Partnership Liabilities of Stockholders Under Section 71, New York Stock Corporation Law, 28 N.Y.U.L. Rev. 1149 (1953) for a more detailed discussion of the Compass incident.

25. Of the more than 2,300 shareholders less than fifteen shared the liability. The personal liability of these New York residents would have been even higher had it not been for a substantial contribution by the major out-of-state stockholder. Rogers & McManus, supra note 24, at 1156 n.29.

shareholders against whom liability was asserted must have been chosen simply because they were present within the jurisdiction.[26] There was no statutory provision for pro rata liability. Rather, shareholders owning one share were equally liable with the corporation's major shareholder. It was evident also that trusts, charities, or pension funds could be held liable and a trustee or other fiduciary upon whom liability was imposed could be held answerable for breach of his fiduciary duty.[27]

The statute gave no right of contribution to the shareholder who was compelled to pay, and although there is authority for the proposition that a right of contribution would have been recognized and enforced by the courts,[28] its value would have been minimal because of the practical impossibility of complying with the procedural requirements.[29] No distinction was made between the liability of a donee and a purchaser even though the former might have been the victim of fraud. And finally, the notice requirement was unfair both to the laborer, because of its brevity and to the shareholder, because it encouraged an arbitrary choice among chargeable stockholders.[30]

The New York Business Corporation Law

The Joint Legislative Committee to Study Revision of Corporation Laws, created in 1956 to undertake a general rewriting of the corporation laws of New York State, recognized the need for revising section 71.[31] The Subcommittee on Relations with Labor and Industry made repeal or amendment of the section one of its prime objectives.[32] It was a known fact that section 71 was one of the more substantial reasons why New York enterprises eschewed incorporation under New York law.[33] Incorporation outside of New York quite ob-

26. No formula was ever proposed to determine why or how these stockholders and not others were chosen. Rogers & McManus, supra note 24, at 1154-55.

27. Rogers & McManus, supra note 24, at 1158. The trustee or fiduciary is protected from personal liability. N.Y. Stock Corp. Law § 72 provides: "No . . . trustee, unless he shall have voluntarily invested the trust funds in such shares, shall be personally liable as a stockholder, but the . . . funds in the hands of such . . . trustee shall be liable." This provision, however, would not protect him from liability to the beneficiaries of the trust for breach of his fiduciary duty. See generally Scott, Trusts § 227 (1960).

28. In the Matter of Cohen, 149 Misc. 765, 772, 269 N.Y. Supp. 235, 244 (Surr. Ct. 1933).

29. Koons v. Martin, 66 Hun 554 (N.Y. Sup. Ct. 1893), aff'd, 143 N.Y. 672, 39 N.E. 21 (1894), requires that for an action for contribution to be maintained against one shareholder, all must be joined.

30. Writers in two legal periodicals recommended amendment or repeal of § 71 because of these many problems. Brownell, The Not-So-Limited Liability of Stockholders of New York Corporations, 27 N.Y.S. B. Bull. 58 (1955); Rogers & McManus, Stockholders' Booby-Trap: Partnership Liabilities of Stockholders Under Section 71, New York Stock Corporation Law, 28 N.Y.U.L. Rev. 1149 (1953).

31. Joint Legislative Committee to Study Revision of Corporation Laws, Interim Report, N.Y. Leg. Doc. No. 17, p. 32 (1957).

32. Id. at 36, 42.

33. Id. at 79, 81.

viously afforded the stockholders greater protection against personal liability. In the next few years however, because of the lack of active participation by the subcommittee members representing labor organizations, little was done toward solving the problem.[34] In the meantime, shareholder liability for wages was omitted from the tentative drafts.[35] Three months before the enactment of the final draft, and although it was omitted from all the tentative drafts, the wage-liability amendment was introduced[36] and subsequently added as Section 630 of the new Business Corporation Law. This is the modern counterpart of section 71 and although it is a complete revision of that section, it still leaves New York in accord with the distinct minority[37] of states which provide for shareholder liability for wages.

Changes Made by Section 630

The statute limits liability to the ten largest shareholders of a corporation whose shares are not listed or regularly traded on a national exchange.[38] Shareholder status is determined by beneficial interest at the time the employee's services terminate[39] and a right of contribution from the other shareholders liable under the statute is given to the shareholder who has paid more than his pro rata share.[40] The procedural difficulty which formerly surrounded an action for contribution is alleviated because the paying shareholder may now sue any of his fellow shareholders liable under this section, without having to join them all.[41]

The protection afforded by the 1952 amendment,[42] that is, liability for vacation pay and other fringe benefits, is retained[43] and the notice requirement is lengthened from thirty to ninety days.[44] The employee is also given a right to examine the record of shareholders to determine whom to serve with notice.[45] Of course, the requirement that judgment against the corporation must first be returned unsatisfied has been retained.[46]

34. Joint Legislative Committee to Study Revision of Corporation Laws, Second Interim Report, N.Y. Leg. Doc. No. 23, p. 46 (1958); Third Interim Report, N.Y. Leg. Doc. No. 39, p. 88 (1959).

35. Joint Legislative Committee to Study Revision of Corporation Laws, Second Interim Report, N.Y. Leg. Doc. No. 23, p. 101 (1958); Third Interim Report, N.Y. Leg. Doc. No. 39, p. 139 (1959); Fourth Interim Report, N.Y. Leg. Doc. No. 15, p. 79 (1960); Supplement to Fourth Interim Report, N.Y. Leg. Doc. No. 15, pp. 42, 90, 111 (1960); Supplement to Fifth Interim Report, N.Y. Leg. Doc. No. 12, pp. 44, 87 (1961).

36. N.Y. Sen. Int. 523, Print. 523 (1961); N.Y. Assembly Int. 837, Print. 837 (1961).

37. See note 6 supra.

38. N.Y. Bus. Corp. Law § 630(a), eff. April 1, 1963.

39. Ibid.

40. N.Y. Bus. Corp. Law § 630(c).

41. Ibid.

42. N.Y. Sess. Laws 1952, ch. 794, § 2.

43. N.Y Bus. Corp. Law § 630(b).

44. N.Y. Bus. Corp. Law § 630(a).

45. Ibid.

46. Ibid.

Problems Arising Under Section 630

Although it answers some of the criticism and some of the problems which arose under section 71, section 630 has created some of its own. If the tenth, eleventh, and twelfth largest shareholders all own an equal amount of stock, who then is liable? And if some of the ten largest shareholders live out of state, the New York resident, because he alone is subject to service of process, could be held solely liable. This difficulty is tempered by the right of contribution but the enforcement of contribution would still necessitate suing in another jurisdiction. Although most unlikely in a close corporation, this could lead to a costly extreme of maintaining as many as nine separate suits in nine different states. The liability of a trust remains, though it is minimized if not eliminated for practical purposes simply because the new statute is limited to close corporations.

Is This Statute Necessary?

When the forerunner of section 71 was first enacted in 1848 there was a need to protect laborers who were unfortunate enough to work for an insolvent corporation. However, since then there has been a decided change in attitude toward limited liability,[47] and salutary measures have been enacted outside of the corporation laws to protect employees generally.

The Federal Bankruptcy Act gives second priority to claims for wages under $600 earned by laborers within three months before bankruptcy.[48] The New York Debtor and Creditor Law, which includes fringe benefits in its definition of wages, gives the same claims first priority.[49] Wage claims are also given first priority upon the appointment of a receiver.[50] Except in certain instances, wages must be paid weekly and employees are not required to accept any other arrangement.[51] Finally, it is a misdemeanor for officers of a corporation knowingly to permit the corporation to fail to pay any employee his wages.[52] In the light of these statutory provisions the necessity for the additional protection given by section 71 and the new section 630 would seem quite questionable.

CONCLUSION

Section 630 of the Business Corporation Law guarantees that the Compass calamity will not occur again in New York. The shareholder remains, however, the prime target for severance pay and fringe benefit claims. Would not the mandatory funding of fringe benefits give better protection to employees? The arbitrary choice of the ten largest shareholders as an

47. "Limited liability is the rule, not the exception; and on that assumption large undertakings are rested, vast enterprises are launched, and huge sums of capital attracted." Anderson v. Abbott, 321 U.S. 349, 362 (1944).

48. 30 Stat. 563 (1898), as amended, 11 U.S.C. § 104(a) (1958).

49. N.Y. Debt. & Cred. Law § 22.

50. N.Y. Gen. Corp. Law § 180.

51. N.Y. Lab. Law § 196.

52. N.Y. Pen. Law § 1272.