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A corporate president's authority to commence corporate litigation

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Even where a president's authority to authorize a corporation to commence litigation is lacking, however, a corporate president who is also a stockholder of the corporation may be able to seek relief for the corporation through a shareholder derivative action, contributors Thomas J. Hall and Judith A. Archer write.

A corporation's board of directors customarily is entrusted with overall management control of a corporation, whether through its articles of incorporation, its bylaws or applicable law. As such, the decision to have a corporation commence, or refrain from commencing, litigation usually rests with its board. There are times, however, recognized by the New York Court of Appeals and other precedent, when absent board action those decisions may validly be made by the corporation's president.

We examine below the divergent court of appeals decisions on this issue, and the application of the legal principles in those decisions by the Commercial Division. These decisions focus on the interplay between a president's authority to commence litigation and the action or inaction by the corporation's board on that issue. Even where a president's authority to authorize a corporation to commence litigation is lacking, however, a corporate president who is also a stockholder of the corporation may be able to seek relief for the corporation through a shareholder derivative action.

Appellate precedent

In the seminal case *Sterling Industries v. Ball Bearing Pen*, 298 N.Y. 483 (1949), the New York Court of Appeals was faced with the issue of whether the president of a corporation had authority to initiate litigation on behalf of the corporation where its board of directors had deadlocked in its vote to commence litigation. Plaintiff Sterling had an exclusive contract with the defendant Ball Bearing for Ball Bearing to manufacture and supply pens, which Ball Bearing allegedly breached. Sterling's bylaws contained the standard provision, consistent with New York's General Corporation Law in existence at that time, that "the affairs and business of the corporation shall be managed" by its board. Significantly, the defendant that was the target of litigation controlled two of the four seats on plaintiff Sterling's board. Prior to commencing litigation, the plaintiff's president called for a special meeting of Sterling's board to vote on commencing litigation against Ball Bearing and, not surprisingly, the board deadlocked in a two-two vote. With the

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board deadlocked, the plaintiff's president then authorized the commencement of litigation. The court of appeals held that, because the corporate bylaws did not empower the president to commence litigation, any authority Sterling's president had to authorize the corporation to commence litigation had terminated when the deadlocked board failed to sanction it. The court explained that the existence of a deadlock did not create "approval of presidential power where none in fact exists." The court added, however, that Sterling's president was not without a remedy; as a Sterling shareholder, its president had standing to bring a shareholder derivative action against Ball Bearing, provided the pre-conditions for such were satisfied. In response to the president's concern that resorting to a derivative action, being equitable, would eliminate the right to a jury trial, the court stated that there was no reason to conclude that a jury trial in an action at law "is in any way essential to the corporate interest."

Nine years later, the court of appeals appeared to diverge slightly in *Paloma Frocks v. Shamokin Sportswear*, 3 N.Y.2d 572 (1958), as it considered whether a corporate president was authorized to commence an arbitration on behalf of his corporation. Respondent Paloma had a service agreement with claimant Shamokin to assist the claimant in the manufacture of dresses. That agreement, signed by the president of each party, contained a broad arbitration clause. Paloma controlled half of the seats on the Shamokin board. Following Paloma's alleged failure to pay Shamokin, Shamokin's president directed Shamokin to commence arbitration against Paloma, and Paloma moved to stay arbitration contending that the arbitration had been commenced without corporate authority. Paloma asserted that the Shamokin board did not hold a meeting to vote on whether to bring an arbitration claim against Paloma and, if it had, half of its directors (being the Paloma designees) would have voted against it. In holding that the arbitration was authorized, the court relied on the fact that, unlike *Sterling*, the Shamokin board never addressed the issue and had not raised any prohibition to or disapproval of the bringing of that claim. The court further relied on the fact that the Shamokin board had previously authorized its president to execute the services agreement containing a broad arbitration clause, adding: "Authorization of a corporation president to agree to a general arbitration clause amounts to an authorization to the president to carry on arbitrations of such disputes as may arise." The court's analysis suggested that, had the Shamokin board prior to the commencement of arbitration held a vote that rejected or deadlocked on the commencement of arbitration, this case may have fallen in line with *Sterling*.

The significance of the board's lack of explicit disapproval was further emphasized in the court of appeals decision one year later in *West View Hills v. Lizau Realty*, 6 N.Y.2d 344 (1959). There, the plaintiff corporation brought an action against a defendant corporation with which it shared all of its officers. The commencement of the suit was authorized by the plaintiff's president, a minority shareholder of the plaintiff. In finding that the president was empowered to authorize the corporation to commence that action, the court of appeals applied what it called an "accepted principle" that, where there has been no direct prohibition against the president taking such action—for example either in the bylaws giving the board exclusive authority to commence litigation or a pre-litigation vote by the board against or deadlocked on commencing litigation—"the president has presumptive authority, in the discharge of his duties, to defend and prosecute such in the name of the corporation."

Similar to *Paloma*, the West View Hills board had taken no action to explicitly prohibit the litigation, and the court's opinion distinguished this case from *Sterling* where its board, through its deadlock, had explicitly refused to approve the commencement of litigation. The fact that West View Hills' president was only a minority shareholder compared to the controlling shareholder status of the *Sterling* and *Paloma* presidents did "not deprive the West View Hills president of his right and duty to perform the obligations and functions of his office as president." The court did not address whether the outcome might have changed in the event of subsequent board action, the court noting that the West View Hills board had stipulated to take no action while that appeal was pending.

Commercial division application

Recent Commercial Division decisions have carefully navigated this roadmap established by these court of appeals decisions.

In *Machaneinu v. Luria*, 42 Misc. 3d 1204(A) (Kings Co. Dec. 20, 2013), the plaintiff operated a camp for children in New York State. Its 50% shareholder and former employee allegedly opened a competing camp and began soliciting the plaintiff's clientele. In response, the plaintiff's president authorized his corporation to sue the defendant competitor. Following the commencement of that litigation, the plaintiff's 50% shareholder arranged for a meeting of the plaintiff corporation's board, which removed its president from the board and then resolved that the litigation be discontinued. Justice Carolyn E. Demarest of the Kings County Commercial Division found that, while the corporate president initially had authority to initiate the suit, his removal from the board and the vote by the reconstituted board to discontinue the suit divested the president of authority to maintain the suit. The court noted that its decision was in line with a Third Department decision in *Stone v. Frederick*, 245 A.D.2d 742, 744-45 (3d Dept. 1997), finding that the appropriate vehicle for suits between owners of an equally owned corporate entity is a shareholder derivative action and not a direct action by the corporation.

Most recently, in *NW Media Holdings v. IBT Media*, No. 652344/2022, 2022 WL 17991353 (N.Y. Co. Dec. 28, 2022), Justice Melissa A. Crane of the New York Commercial Division considered whether, in the face of internal opposition, a corporate president was authorized to have his corporation bring suit against the defendant corporation. The court characterized this dispute as being between two former friends and business associates, Jonathan Davis and Dev Pragad, who "seek to gain the upper hand against one another over who controls Newsweek, a media brand." Pragad was the president of plaintiff NW Media, the owner of Newsweek LLC, who caused NW Media to sue IBT Media, an entity controlled by Davis. The defense countered that the litigation, allegedly being orchestrated by Pragad as a means to use plaintiff's corporate assets to fund his personal vendetta against Davis, was commenced by Pragad without corporate authority.

The court began its analysis by observing: "This motion is legally fascinating because there appears to be two distinct lines of cases that lead to opposite results." The court reviewed the court of appeals decision in *Sterling*, noting that the refusal of the plaintiff's board there to authorize litigation disabled its president from doing so. The court observed that several of the cases that followed Sterling "cement the concept that, where the bylaws do not overtly give the president the right to commence litigation, and there is board or shareholder deadlock about the propriety of doing so, the president then lacks the authority to bring an action directly in the name of the corporation."

The court then addressed the court of appeals decision in *Paloma*, stating that it "seemingly cut back on *Sterling*'s holding." The court observed that the *Paloma* court relied on the fact that there was no direct prohibition from the board to the commencement of litigation, and that the board had previously approved the contract containing the broad arbitration clause. The court further distinguished the court of appeals decision in *West View Hills*, in which, unlike *Sterling*, the board had taken no action.

Turning to the facts, defendant IBT, owned by Davis, had sold Newsweek to NW Media, which was owned 50/50 by Davis and Pragad and of which Pragad was president. NW's Media's lawsuit against IBT sought indemnification under the parties' purchase agreement for certain taxes and other amounts paid by NW Media. No formal vote of the plaintiff board had been called. However, prior to bringing this lawsuit, the plaintiff's president Pragad showed Davis, as a 50% owner of the plaintiff, a draft complaint and Davis "strenuously objected in writing to its filing." While no board vote was taken, the court found that Davis's objection effectively resulted in a deadlock, stating that the court declined to "elevate form over substance." The court found these facts caused the case to fall squarely within the *Sterling* line of cases and, thus, the plaintiff president lacked authority to bring the suit. It went on to observe that the plaintiff president's recourse was to bring a derivative suit.

Conclusion

The above cases reflect the fact-specific inquiry in which courts must engage to determine a corporate president's authority to have the corporation commence suit. The precedent of the New York Court of Appeals, with many nuances, mandates this factual discipline. Of course, a specific bylaw setting forth where such authority rests should avoid the need for such disputes. Absent that, while some precedent indicates a president does have presumptive authority to commence such litigation, assertiveness by the corporation's board may negate this right.