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F. Hodge O'Neal

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# DEVELOPMENTS IN THE REGULATION OF THE CLOSE CORPORATION

*F. Hodge O'Neal*†

Before World War II, the same rules were applied with few exceptions to public-issue corporations and to close corporations. Legislatures and courts seldom recognized the differences in the nature and needs of the two types of corporations; even less did they attempt to formulate rules and concepts to meet the special problems of close corporations.

Similarly, treatises and other books generally did not differentiate in their analyses of legal problems between the corporate giants and close corporations. Even books of corporation forms did not distinguish between specimen provisions suitable for use in charters, by-laws, and other documents of public-issue corporations and those appropriate for use in documents for close corporations. The editor or law teacher putting together a form book, usually having had little or no experience himself in actual corporate practice, went to the corporate giants with their high-priced legal talent, supposedly the best, for specimen documents to include in the book. Apparently the thought did not occur to anyone—or if it did he quickly suppressed it—that however splendidly these documents served the purposes for which they were drafted they might not be adapted to the needs of a closely-held enterprise.

It is not surprising that under these conditions most lawyers turned out close corporations that were small replicas of public-issue corporations. Seldom was an effort made to eliminate from the corporate form any of the traditional corporate attributes, no matter how disadvantageous and undesirable those attributes might be in a small, closely-held business. Still less frequently did a lawyer recognize that the uniqueness of each business enterprise might call for really individualized tailoring of the corporate form to the needs of the particular enterprise.

Even before World War II, however, a few voices "cried out," advocating statutory and judicial recognition of the special needs and problems of one-man companies, family corporations, and incorporated partnerships.<sup>1</sup> For instance, Joseph L. Weiner, a New York practitioner, after

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† A.B. 1938, LL.B. 1940, Louisiana State University; J.S.D. 1949, Yale University; S.J.D. 1954, Harvard University; Professor of Law, Duke University. Author, *Close Corporations: Law and Practice* (1958) (2 vols.); co-author (with Jordan Derwin), *Expulsion and Oppression of Business Associates* (1961); co-author (with Kurt F. Pantzer), *The Drafting of Corporate Charters and By-Laws* (1951); Editor, "The Corporate Practice Commentator."

The author acknowledges his indebtedness to W. Reece Bader, senior student at the Duke University School of Law, for research assistance and aid in preparing the manuscript of this article.

<sup>1</sup> Fuller, "The Incorporate Individual: A Study of the One-Man Company," 51 *Harv. L. Rev.* 1373, 1406 (1938):

discussing at length the distinctive characteristics and needs of the close corporation and the inappropriateness of applying many provisions of the corporation statutes to close corporations, concluded:

If we are to avoid burdening the private company with regulations necessary only for the large, we must sever the small and the large. Equally so if we are to regulate the large with a proper consideration of the interests involved.<sup>2</sup>

And Wiley B. Rutledge, Jr., then Dean of the College of Law of the University of Iowa, later Associate Justice of the United States Supreme Court, after examining trends in what were then the most recently enacted corporation statutes and finding many of the provisions unsuited for one-man companies and close corporations, stated:

It would seem that an intelligent approach to the general problem of incorporation would require at least three types of general incorporation laws in each state: One for the single incorporator, another for the small concern, and a third for the extensive business setup . . . .<sup>3</sup>

Since World War II, extensive developments have occurred in close corporation law and practice. This article discusses those developments, pointing out the respective roles therein of lawyers, legal writers, legislatures, and courts.

#### THE ROLE OF LAWYERS AND WRITERS

It is a tribute to the resourcefulness and persistence of some members of the corporate bar and of a handful of law teachers and writers that the close corporation has evolved into a virtually new type of business organization, much better suited than the older corporate form to family and other closely-held enterprises. Despite the clumsy legal rules, some skilled and conscientious lawyers organizing closely-held enterprises struggled to set up business structures suited to the enterprises and calculated to gratify the legitimate desires of their clients. For instance, they tried—and with considerable success—in some of the corporations they organized to eliminate majority rule and free transferability of shares.

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Existing incorporation statutes assume that this type of company [the one-man company] shall be operated and governed in the same manner and subject to the same limitations and restrictions as apply to the company with a thousand shareholders, despite the existence of numerous and important dissimilarities between the two types of enterprises. . . . [I]t would seem highly desirable that the movement for the modernization of incorporation statutes should take cognizance of its [the one-man company's] peculiar problems and needs through the inclusion in new legislation of provisions appropriate to the management and control of this type of enterprise.

<sup>2</sup> Weiner, "Legislative Recognition of the Close Corporation," 27 Mich. L. Rev. 273, 284 (1929).

<sup>3</sup> Rutledge, "Significant Trends in Modern Incorporation Statutes," 22 Wash. U.L.Q. 305, 339 (1937).

To by-pass the rules which legislatures and courts had evolved for public-issue corporations, but which were restrictive and inappropriate as applied to close corporations, the lawyers had to plan and draft with great imagination and ingenuity. In providing serviceable frameworks for the businesses they organized, they resorted (and continue to resort) to an interesting array of legal devices—pre-incorporation agreements, special charter and by-law clauses, share transfer restrictions, shareholders' agreements of various sorts, voting trusts, irrevocable proxies, and long-term employment contracts.

Legal writers also, soon after World War II, began to concentrate on the problems of close corporations and to turn out vast amounts of literature, much of it devoted to planning and drafting techniques serviceable in tailoring the corporate form to closely-held businesses. This writing reached full tide in the 1950's,<sup>4</sup> but the flow of writing is continuing unabated, many of the articles written in the 1960's focusing on the law of a particular state.<sup>5</sup>

The effect of this growing body of literature has been to refine close corporation planning and drafting techniques and to bring those techniques to the attention of an ever-expanding body of practicing lawyers. Furthermore, the constant harping on the special needs and problems of close corporations undoubtedly has served to educate legislators and judges and to create a favorable climate for a more satisfactory legislative and judicial treatment of close corporations.

#### THE ROLE OF LEGISLATURES

In Great Britain, special statutory provisions govern the "private company," the English equivalent of the American close corporation,<sup>6</sup> but

<sup>4</sup> See, e.g., O'Neal, *Close Corporations: Law and Practice* (1958) (2 vols); Hornstein, "Judicial Tolerance of the Incorporated Partnership," 18 *Law & Contemp. Prob.* 435 (1953); O'Neal, "Molding the Corporate Form to Particular Business Situations: Optional Charter Clauses," 10 *Vand. L. Rev.* 1 (1956); Powers, "Cross Fire on the Close Corporation: Norms Versus Needs," 11 *U. Fla. L. Rev.* 433 (1958); Scott, "The Close Corporation in Contemporary Business," 13 *Bus. Law.* 741 (1958); "Symposium—Close Corporations," 52 *Nw. U.L. Rev.* 345 (1957).

<sup>5</sup> See, e.g., Cross, "The Close Corporation in Connecticut," 35 *Conn. B.J.* 432 (1961); Ham, "The Close Corporation Under Kentucky Law," 50 *Ky. L.J.* 125 (1961); Kessler, "Certificate of Incorporation for a New York Close Corporation: A Form," 33 *Fordham L. Rev.* 541 (1965); Neef & Sullivan, "The Close Corporation in Michigan," 39 *Mich. S.B.J.*, July 1960, p. 8; Oppenheim, "The Close Corporation in California—Necessity of Separate Treatment," 12 *Hastings L.J.* 227 (1961); Stevens, "Close Corporations and the New York Business Corporation Law of 1961," 11 *Buffalo L. Rev.* 481 (1962).

<sup>6</sup> For a discussion of the British private companies, see McFadyean, "The American Close Corporation and Its British Equivalent," 14 *Bus. Law.* 215 (1958). The "private company" is defined as a company "which (a) limited the membership to fifty, (b) restricted the right to transfer shares, and (c) prohibited any invitation to the public." Gower, *The Principles of Modern Company Law* 13 (1954). The Jenkins Committee on Company Law Reform, however, has recommended that the distinction between public and private companies be abolished. *Company Law Reform Committee, Cmnd. No. 1749, ¶¶ 31, 63, 67* (1962). For discussions of the Committee Report, see Pennington, *Company Law Reform* (pts. 1 and 2),

in this country, with one exception to be noted later, the states have not enacted separate statutes for the close corporation. One reason for the legislative failure to provide separate rules for the close corporation has been the difficulty of finding a satisfactory definition of the close corporation.<sup>7</sup> This difficulty is illustrated by the experience of the New York Joint Legislative Committee to Study Revision of the Corporation Laws, the committee that drafted the new New York Business Corporation Law. At the very inception of the revision study, the committee explored the desirability of a separate "Close Business Corporation Law," but after investigation it concluded that the close corporation could not be defined with sufficient precision to delineate clearly between close corporations and public-issue corporations.<sup>8</sup> A second reason for the failure of legislatures to enact separate close corporation statutes might be a fear that separate legislation would impede the growth of close corporations and hinder the gradual evolution of the more successful of the closely-held enterprises into public-issue corporations. Thirdly, some lawyers serving giant corporations have fought separate treatment of small incorporated enterprises, perhaps because separation would tend to isolate the giant companies politically (depriving them of their identification with politically potent small business) and perhaps lead to separate and more severe regulation and taxation for the giant corporations.

Even though the state legislatures—with the one exception to be noted later—have not seen fit to enact separate statutes for close corporations, the labors of the pioneer writers who pleaded so eloquently for legislative recognition of the close corporations have not been entirely in vain. Most corporation statutes enacted since World War II contain a number of provisions which alleviate problems of the close corporation. Some of these statutory provisions, although they apply to both public-issue and close corporations, give an increased flexibility to the corporate form and thus permit a tailoring of the corporate device to the needs of closely

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107 Sol. J. 163, 184 (1963); Note, 25 Modern L. Rev. 703 (1962). For a discussion of business units on the European continent similar to the American close corporation, see Treillard, "The Close Corporation in French and Continental Law," 18 Law & Contemp. Prob. 546 (1953). For an explanation of special German statutes, see Schneider, "The American Close Corporation and Its German Equivalent," 14 Bus. Law. 228 (1958).

<sup>7</sup> As early as 1948, the New York Law Revision Commission struggled unsuccessfully with the definitional problem. See 1948 N.Y. Law Revision Comm'n 381-427 (1948). In the same year, Isaacs commented "that no satisfactory all-purpose definition of a close corporation appears ever to have been worked out . . ." Isaacs, "The Close Corporation and the Law," 33 Cornell L.Q. 488, 491 (1948).

<sup>8</sup> See Joint Legislative Comm. To Study Revision of Corporation Laws, (First) Interim Report to 1957 Session of N.Y. State Legislature, 1957 N.Y. Leg. Doc. No. 17, at 115, as discussed in Hoffman, "New Horizons for the Close Corporation in New York Under Its New Business Corporation Law," 28 Brooklyn L. Rev. 1-2 (1961).

held enterprises. Other provisions were drafted primarily to meet the needs of close corporations, and in practical operation apply largely, if not exclusively, to such corporations.

Statutory provisions beneficial to the close corporation found in one or more states include the following:<sup>9</sup> (1) statutes giving the corporate form greater flexibility by authorizing the use of optional charter clauses<sup>10</sup> and special by-law provisions;<sup>11</sup> (2) statutes permitting a corporation to be formed by a single incorporator;<sup>12</sup> (3) statutes permitting a corporation to have less than the traditional three directors;<sup>13</sup> (4) statutes authorizing high quorum and high vote requirements for shareholder and director action;<sup>14</sup> (5) statutes relaxing the requirements of formal corporate meetings and permitting directors and shareholders to act by unanimous written consent;<sup>15</sup> (6) statutes expressly authorizing restrictions on the transfer of stock;<sup>16</sup> (7) statutes empowering directors to fix their own compensation as directors and officers;<sup>17</sup> (8) statutes in a few states requiring directors to declare dividends in specified circumstances;<sup>18</sup> (9) statutes sanctioning shareholder agreements allocating corporate control and impinging upon powers traditionally within the province of the board of directors or otherwise departing in important respects from the traditional pattern of corporate management;<sup>19</sup> (10) statutes permitting special contractual arrangements among the shareholders providing when and under what circumstances the corporation will be dissolved or fixing nonstatutory dissolution procedures;<sup>20</sup> (11) statutes authorizing judicial dissolution of a corporation in the event of deadlock among the shareholders or directors (so-called "dissolution on deadlock" statutes);<sup>21</sup> and (12) statutes authorizing court appointment

<sup>9</sup> For a more detailed discussion of many of the statutory sections listed, see O'Neal, "Recent Legislation Affecting Close Corporations," 23 *Law & Contemp. Prob.* 341 (1958).

<sup>10</sup> E.g., Del. Code Ann. tit. 8 § 102(b)(1) (1953); N.Y. Bus. Corp. Law § 402(b). For a discussion of various types of statutes authorizing optional charter clauses, see O'Neal, *supra* note 4, §§ 3.40.

<sup>11</sup> E.g., N.Y. Bus. Corp. Law § 601(c); Ohio Rev. Code Ann. § 1701.15 (Baldwin 1953).

<sup>12</sup> E.g., Ill. Ann. Stat. ch. 32, § 157.46 (Smith-Hurd Supp. 1964); Mich. Comp. Laws § 450.3 (Supp. 1961); Wis. Stat. § 180.44 (1961).

<sup>13</sup> E.g., Del. Code Ann. tit. 8, § 141(b) (Supp. 1964); Ill. Ann. Stat. ch. 32, § 157.34 (Smith-Hurd Supp. 1964). These statutes provide that where the corporation has less than three shareholders, the number of directors may be less than three but not less than the number of shareholders.

<sup>14</sup> E.g., N.Y. Bus. Corp. Law §§ 616, 709; Del. Code Ann. tit. 8, § 102(b)(4) (1953); Wis. Stat. §§ 180.28, 35 (1961).

<sup>15</sup> E.g., Del. Code Ann. tit. 8, § 228 (1953); Mich. Comp. Laws § 450.13 (Supp. 1961).

<sup>16</sup> E.g., Cal. Corp. Code § 501(g); Tex. Bus. Corp. Act art. 2.22 (1956).

<sup>17</sup> E.g., Ohio Rev. Code Ann. § 1701.60 (Page 1964); Wis. Stat. § 180.31 (1961).

<sup>18</sup> E.g., N.M. Stat. Ann. § 51-3-16 (1953).

<sup>19</sup> E.g., N.Y. Bus. Corp. Law § 609; N.C. Gen. Stat. § 55-68 (1960).

<sup>20</sup> E.g., N.C. Gen. Stat. § 55-125(3) (1960); Wyo. Stat. Ann. § 17-36.31 (1961).

<sup>21</sup> E.g., Cal. Corp. Code §§ 4650-51; Ill. Stat. Ann. ch. 32, §§ 157.86-91 (Smith-Hurd 1954); N.Y. Bus. Corp. Law § 1104.

of a provisional director for a corporation with a board of directors that is evenly divided on management policies.<sup>22</sup>

Perhaps brief mention should be made of one piece of legislation in which Congress singled out the close corporation for special treatment. Subchapter S,<sup>23</sup> which was added to the Internal Revenue Code by the Technical Amendments Act of 1958,<sup>24</sup> permits small business corporations that meet specified requirements to elect a special tax status in many respects similar to that of a partnership.<sup>25</sup> Among the requirements for eligibility to elect this status are that the corporation be a domestic corporation, that it have only one class of stock, and that it have less than eleven shareholders. Obviously a public-issue corporation cannot qualify; many, if not most, close corporations can.

#### THE ROLE OF THE PIONEERING STATES

Four states—New York, North Carolina, South Carolina, and Florida—rate special mention as innovators in legislation applicable to close corporations. One of the earliest and perhaps the most publicized statute avowedly passed to meet special needs of close corporations was Section 9 of the New York Stock Corporation Law, enacted in 1948.<sup>26</sup> That statute, enacted on the recommendation of the New York Law Revision Commission, authorized inclusion in the certificate of incorporation of New York corporations of provisions fixing high quorums and requiring high votes for shareholder and director action. This legislation, which permitted organizers of a corporation to give minority shareholders a power to veto corporate decisions, was hailed at the time of its passage as the first important legislative recognition of the special management needs of close corporations.<sup>27</sup>

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<sup>22</sup> E.g., Cal. Corp. Code § 819; Mo. Ann. Stat. § 315.323 (Supp. 1964).

<sup>23</sup> Internal Revenue Code of 1954, §§ 1371-77.

<sup>24</sup> P.L. 85-866, § 64(a), 72 Stat. 1650 (1958).

<sup>25</sup> The Senate Finance Committee stated that an objective of Subchapter S was to permit businesses to elect a form of business organization "without the necessity of taking into account major differences in tax consequences." S. Rep. No. 1983, 85th Cong., 2d Sess. 1 (1958). Subchapter S is sometimes inaccurately described as permitting a qualifying corporation to elect to be taxed as a partnership. The subchapter actually provides, however, for an entirely new classification—one that differs in important respects from the partnership. Since important tax differences exist between the tax status of a partnership and the status of a corporation that elects under Subchapter S, choosing a business form for a closely held enterprise is now considerably more difficult than it was before the enactment of Subchapter S because there is now an additional alternative to consider.

<sup>26</sup> N.Y. Stock Corporation Law § 9 (1948), N.Y. Sess. Laws, c. 862, § 1, as amended (1948). This statutory section has now been replaced by the N.Y. Bus. Corp. Law.

<sup>27</sup> de Capriles & Reichardt, "1947-1948 Survey of New York Law—Corporations," 23 N.Y.U.L.Q. Rev. 747 (1948). Actually, high quorum and high vote requirements had been authorized in a number of states at an earlier date. E.g., Del. Code Ann. tit. 8, § 102(b)(4) (1953), enacted in 1935; Cal. Corp. Code § 816, enacted in 1947.

The first really extensive and imaginative statutory innovations to meet close corporation needs occurred, however, in the North Carolina Business Corporation Act,<sup>28</sup> enacted in 1955. The drafting commission for that act—under the leadership of Dean Elvin R. Latty of the Duke University School of Law—made a diligent study of the peculiarities of close corporations, and many sections of the statute were drafted with the special needs of close corporations in mind.<sup>29</sup> Legislators in other states might well give serious consideration to this imaginative and carefully drawn legislation.

Perhaps two pioneering sections of the North Carolina statute deserve special attention. One of these sections<sup>30</sup> contains provisions to the following effect: (1) a contract between two or more shareholders to vote their shares as a unit for the election of directors shall be enforceable between the parties for as long as ten years, if it is in writing and signed by the parties; (2) in a corporation whose shares are not generally traded in the markets a written agreement to which all the shareholders have assented (whether embodied in the charter or by-laws or in a side agreement signed by all the parties) which relates to any phase of the corporation's affairs, shall not be invalidated on the ground that its effect is to make the parties partners among themselves; and (3) an agreement among some or all of the shareholders in a corporation, whether solely among themselves or between one or more of them and a non-shareholder, is not invalid as between the parties on the ground that it interferes with the discretion of the board of directors, but by making such an agreement the shareholders who are parties assume the same liability as directors for managerial acts.<sup>31</sup>

The other section<sup>32</sup> authorizes judicial liquidation of a corporation in an action by a shareholder if the corporation's charter or any other

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<sup>28</sup> N.C. Gen. Stat. §§ 55-1 (1960); N.C. Laws, c. 1371 (1955).

<sup>29</sup> See Latty, "The Close Corporation and the New North Carolina Business Corporation Act," 34 N.C.L. Rev. 432 (1956); Latty, Powers & Breckinridge, "The Proposed North Carolina Business Corporation Act," 33 N.C.L. Rev. 26, 45 (1954).

<sup>30</sup> N.C. Gen. Stat. § 55-73 (1960).

<sup>31</sup> See also N.C. Gen. Stat. § 55-24(a) (1960): "Subject to the provisions of the charter, the by-laws or agreements between the shareholders otherwise lawful, the business and affairs of a corporation shall be managed by a board of directors."

<sup>32</sup> N.C. Gen. Stat. § 55-125(a) (1960):

(a) The superior court shall have power to liquidate the assets and business of a corporation in an action by a shareholder when it is established that:

(3) All of the present shareholders are parties to, or are transferees or subscribers of shares with actual notice of a written agreement, whether embodied in the charter or separate therefrom, entitling the complaining shareholder to liquidation or dissolution of the corporation at will or upon the occurrence of some event which has subsequently occurred . . . .

written agreement among all the shareholders entitled the complaining shareholder to liquidation or dissolution at will or on the occurrence of events which have subsequently occurred.<sup>33</sup>

The new South Carolina Business Corporation Act,<sup>34</sup> passed in 1962, also focuses on the close corporation. The Reporter of the draft version of that act, Professor Ernest L. Folk III, stated that one of the principal guidelines of the draftsmen was the desire to permit shareholders in a close corporation to act in the corporation's internal affairs almost as freely as if they were in a partnership.<sup>35</sup> Henry B. Richardson, Chairman of the Joint Committee that drafted the act, described the draftsmen's efforts to prepare an act suitable for the close corporation, commenting as follows:

The draft statute gives special attention to the needs of the small, closely held family enterprise which undoubtedly comprises the majority of all present South Carolina corporations. New statutes increasingly recognize the needs of these small corporations which are almost identical with partnerships except for their limited liability as to third parties. First of all, many provisions state a rule of law which is applicable only unless the articles of incorporation provide otherwise. Thus, there is wide leeway for the businessman and his lawyer to plan the corporate structure which best suits his needs. These provisions can readily be identified because they start with language such as 'Unless the articles of incorporation otherwise provide,' or 'subject to the articles of incorporation.' Thus, the closely held enterprise may manage its affairs directly by the shareholders or by a board of directors no larger than the number of shareholders, *e.g.*, one director when there is a single shareholder, two directors when there are two shareholders, etc. In addition, [sections 22-16.15 and 22-16.22] . . . validate agreements among shareholders with respect to voting and as to the internal management of corporate affairs, respectively. Creditor rights, however, remain wholly unimpaired. Other provisions validate the kind of informal action by directors and shareholders which is so typical of the smaller enterprise. Finally, the draft Act facilitates dissolution of the corporation which is paralyzed by deadlock, but also provides for alternative relief which may save the enterprise as a going concern. Indeed, the protection of minority interests and the enforcement of the duties of directors and majority shareholders is important, not only to secure justice, but also to encourage investment in local enterprises. For by assuring investors that they will be protected by the courts, we can give them stronger inducement to place their funds in local enterprises, thereby promoting the state economy as a whole.<sup>36</sup>

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<sup>33</sup> For a discussion of several other sections of the North Carolina act which are particularly applicable to close corporations, see Latty, *supra* note 29.

<sup>34</sup> S.C. Code Ann. §§ 12-11.1 to -31.2 (Supp. 1964); Laws of S.C. (1962 [52] 1996).

<sup>35</sup> Folk, "The Model Act and the South Carolina Corporation Law," 15 S.C.L. Rev. 275, 281 (1963). Incidentally, draftsmen of future corporation statutes would do well to consult the comprehensive and clearly written Reporter's Notes to the draft version of the South Carolina Act.

<sup>36</sup> Richardson, Draft Version, South Carolina Business Corporation Act of 1962, at ix-x (Judicial Council of S.C. 1961). References to sections of the draft statute have been omitted from the quotation.

A provision of the South Carolina Act unique in the United States is section 12-22.23.<sup>37</sup> To be understood that section has to be read together with section 12-22.15(a),<sup>38</sup> which itself is designed to deal with deadlock and dissension in close corporations.

Section 12-22.15(a) gives the courts power to liquidate a corporation in an action brought by a shareholder, whenever: (1) the directors are so divided respecting management that the votes required for action by the board of directors cannot be obtained and the shareholders are unable to terminate the division, with the consequence that (a) the corporation is suffering or will suffer irreparable injury, or (b) the business and affairs of the corporation can no longer be conducted to the advantage of the shareholders generally; (2) the shareholders are so divided that they have failed, for a period which includes at least two consecutive annual meeting dates, to elect successors to directors whose terms have expired or would have expired upon the qualification of their successors; (3) the shareholders are so divided respecting management that (a) the corporation is suffering or will suffer irreparable injury, or (b) the affairs of the corporation can no longer be conducted to the advantage of all the shareholders; (4) the acts of the directors or those in control of the corporation (a) are illegal, or fraudulent, or dishonest, or (b) are oppressive or unfairly prejudicial either to the corporation or to any shareholder; (5) corporate assets are being misapplied or wasted; or (6) the petitioning shareholder has a right under the articles of incorporation to dissolution of the corporation at will or upon the occurrence of a specified event or contingency.

Section 12-22.23 gives the courts unusually broad powers as to remedies. It provides that in an action filed by a shareholder to dissolve the corporation on the grounds enumerated in section 12-22.15, the court may make such order or grant such relief as it deems appropriate, including an order (1) cancelling or altering any provision contained in the articles of incorporation or in the by-laws of the corporation; (2) cancelling, altering, or enjoining any resolution or other act of the corporation; (3) directing or prohibiting any act of the corporation or of shareholders, directors, officers or other persons party to the action; or (4) providing for the purchase at their fair value of shares of any shareholder, either by the corporation or by other shareholders. The section goes on to state that such relief "may be granted as an alternative to a decree of dissolution, or may be granted whenever the circumstances of the case are such that relief, but not dissolution, would be appropriate."

<sup>37</sup> S.C. Code Ann. § 12-22.23 (Supp. 1964) was § 12.23 in the draft statute.

<sup>38</sup> S.C. Code Ann. § 12-22.15(a) (Supp. 1964) was § 12.15(a) in the draft statute.

Section 12-22.15 is based in large part upon Model Act, Section 90,<sup>39</sup> but the Model Act does not contain anything similar to Section 12-22.23. The latter section gives a court broad power to adjust its decree to the particular problem before it, and thus to provide an adequate and lasting solution. In the absence of statute, courts have not felt that they had such broad powers.

Section 12-22.23 was taken from Section 210 of the English Companies Act of 1948.<sup>40</sup> As the Reporter for the South Carolina Act points out, section 210 "has not been invoked, in any reported case or known litigation, with respect to a publicly owned corporation, and indeed it is appropriate only to the closely held enterprise."<sup>41</sup>

The new New York Business Corporation Law,<sup>42</sup> enacted in 1961 and effective in 1963, although geared primarily to public-issue corporations, has an extensive array of close corporation provisions. Only a few of these provisions will be discussed in detail here because the statute's close corporation provisions have been comprehensively discussed elsewhere.<sup>43</sup>

One of the most important provisions of the New York statute is section 620, which states in part:

(a) An agreement between two or more shareholders, if in writing and signed by the parties thereto, may provide that in exercising any voting rights, the shares held by them shall be voted as therein provided, or as they may agree, or as determined in accordance with a procedure agreed upon by them.

(b) A provision in the certificate of incorporation otherwise prohibited by law as improperly restrictive of the discretion or powers of the board in its management of corporate affairs shall nevertheless be valid.<sup>44</sup>

(1) If all the incorporators or holders of record of all outstanding shares, whether or not having voting power, have authorized such provision in the certificate of incorporation or an amendment thereof; and

(2) If, subsequent to the adoption of such provision, shares are transferred or issued only to persons who had knowledge or notice thereof or consented in writing to such provision.

(c) A provision authorized by paragraph (b) shall be valid only so long as the shares of the corporation are not listed on a national securities exchange or regularly quoted in an over-the-counter market by one or more members of a national or affiliated securities association.<sup>45</sup>

A provision of the kind authorized by paragraph (b) relieves the direc-

<sup>39</sup> The Model Act was prepared by the American Bar Association and its Committee on Corporate Laws.

<sup>40</sup> 11 & 12 Geo. 6, c. 38, § 210.

<sup>41</sup> Draft Version, South Carolina Business Act of 1962, at 226.

<sup>42</sup> N.Y. Sess. Laws, c. 855 (1961).

<sup>43</sup> See Hoffman, *supra* note 8.

<sup>44</sup> N.Y. Bus. Corp. Law § 620(g) requires the existence of such a provision to be noted conspicuously on the face or back of every share certificate issued.

<sup>45</sup> N.Y. Bus. Corp. Law § 620(a)-(c).

tors from liability for managerial acts or omissions that is ordinarily imposed on directors and imposes that liability upon the shareholders authorizing the provision or consenting to it, to the extent that and so long as the discretion or powers of the board are controlled by the provision.<sup>46</sup>

Section 630<sup>47</sup> of the New York Business Corporation Law is unusual. Before the passage of that statute, New York<sup>48</sup>—along with a few other states—imposed upon shareholders unlimited liability for debts, wages, and salaries (including “fringe benefits”) the corporation owed employees. In other words, these states made an important exception to the principle that shareholders are shielded from unlimited liability and risk only the funds they invest in the enterprise. Section 630 retains shareholders’ unlimited liability for employee claims, but it imposes this liability only on the ten largest shareholders in a corporation whose shares are not traded on a national exchange or in an over-the-counter market by a national securities association or its affiliate.<sup>49</sup>

In 1963 the Florida legislature enacted the first separate close corporation statute.<sup>50</sup> That statute is set forth in full at the end of this article as an Appendix. Space will not permit a detailed analysis and appraisal of the statute here.

The Florida legislature is to be commended for recognizing that close corporations have special needs that require changes in the law. The statute as enacted, however, is incomplete and vaguely drawn, and therefore does not adequately meet those needs.<sup>51</sup>

#### THE ROLE OF THE COURTS

The legislative changes described in the last two sections of this article have been supplemented by rather extensive judicial developments. Close corporations have been pushing into the courtrooms to strain and erode legal concepts developed for public-issue institutions.<sup>52</sup>

In an increasing number of cases, the courts are not even giving “lip service” to the proposition that a single set of legal principles regulate both public-issue and close corporations. For instance, in recognition of

<sup>46</sup> N.Y. Bus. Corp. Law § 620(f).

<sup>47</sup> N.Y. Bus. Corp. Law § 630.

<sup>48</sup> See Rogers & McManus, “Stockholders’ Booby-Trap: Partnership Liabilities Under Section 71, New York Stock Corporation Law,” 28 N.Y.U.L. Rev. 1149 (1953).

<sup>49</sup> A shareholder who has paid more than his pro rata share is entitled to joint and several contribution from the other nine shareholders with respect to the excess paid.

<sup>50</sup> Fla. Stat. §§ 608.0100-.0107 (1963).

<sup>51</sup> For further discussion of some of these problems, see Note, 16 U. Fla. L. Rev. 569 (1964). For a brief comparison of the Florida statute with those of New York and North Carolina, see 77 Harv. L. Rev. 1551 (1964).

<sup>52</sup> See Prunty, “1959 Survey of New York Law—Business Associations,” 34 N.Y.U.L. Rev. 1425 (1959).

the fact that participants in close corporations usually disregard corporate formalities, courts consistently give effect to informal corporate action. The Supreme Court of Pennsylvania stated not long ago<sup>53</sup> that "a very small or closed corporation is not held to the strict formalities that are applicable to large corporations . . ."<sup>54</sup> And a California court<sup>55</sup> has frankly said that it will not apply the technical rules commonly applied to corporations to "a close family corporation of two shareholders of equal ownership" if the application of those rules will "serve to defeat such equality of ownership, impede justice and perpetrate fraud," and that it will not permit mere "irregularities" in the transactions of a family corporation to affect the validity of those transactions.<sup>56</sup>

The courts are also beginning to draw distinctions between close corporations and public-issue corporations in other kinds of cases. A Wisconsin court<sup>57</sup> has indicated that it considers the issuance of stock for materially less than its value to be stronger evidence of an oppressive scheme against minority shareholders in a close corporation than it would be in a publicly-held corporation. A Pennsylvania court<sup>58</sup> compelled the president of a close corporation specifically to perform a contract in which he promised to sell a specified number of shares in the company to a person accepting employment with it, the court concluding that the purchaser's remedy at law was inadequate because stock in a close corporation is of peculiar value to an employee and such stock is not purchasable on the market and has no quoted or ascertainable market value.

And a number of courts,<sup>59</sup> in cases involving close corporations, have imposed a fiduciary duty on shareholders to exercise the utmost good faith in their dealings with each other. Thus, an Iowa court<sup>60</sup> set aside a new issue of stock to the controlling shareholders of a close corporation on the ground that the issue violated the preemptive rights of a fellow shareholder, even though the complaining shareholder, a well-educated

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<sup>53</sup> *Chambers v. Beaver-Advance Corp.*, 392 Pa. 481, 140 A.2d 808 (1958).

<sup>54</sup> *Id.* at 492, 140 A.2d at 814. Similarly, in *Trager v. Schwartz*, 345 Mass. 653, 189 N.E.2d 509 (1963), the court stated: "This was a small family corporation conducted without over-emphasis on corporate formalities and reasonably is not to be held to the strict standards of larger commercial organizations." *Id.* at 659, 189 N.E.2d at 512. See also *Crane Valley Land Co. v. Bank of America*, 182 Cal. App. 2d 166, 173, 5 Cal. Rptr. 731, 736 (Dist. Ct. App. 1960); *Freeman v. King Pontiac Co.*, 236 S.C. 335, 350, 114 S.E.2d 478, 485 (1960).

<sup>55</sup> *Kauffman v. Meyberg*, 59 Cal. App. 2d 730, 140 P.2d 210 (1943). In this case, the founder of a close corporation had bequeathed all of the stock in it to his two children in equal ownership. The court refused to sustain a contention that one of the children was not entitled to vote his shares because valid share certificates had not been issued to him.

<sup>56</sup> *Id.* at 739, 140 P.2d at 215-16.

<sup>57</sup> *Steven v. Hale-Haas Corp.*, 249 Wis. 205, 227-28, 23 N.W.2d 620, 631 (1946).

<sup>58</sup> *Aldrich v. Geahry*, 360 Pa. 376, 61 A.2d 843 (1948).

<sup>59</sup> *E.g.*, *Gord v. Iowana Farms Milk Co.*, 245 Iowa 1, 60 N.W.2d 820 (1953); *Sher v. Sandler*, 325 Mass. 348, 90 N.E.2d 536 (1950); see generally O'Neal, *supra* note 4, § 8.07.

<sup>60</sup> *Gord v. Iowana Farms Milk Co.*, *supra* note 59.

man and thoroughly familiar with the business, had signed a waiver of his preemptive rights. The court stated<sup>61</sup> that the controlling shareholders were under a duty to disclose to the complaining shareholder before he signed the waiver the actual value of the new shares, that the issue price was less than that value, and that the issue would have a diluting effect on his holdings.

Another illustration of the application of different rules, depending on whether the corporation involved is close or publicly held, is in the admissibility of corporate books and records in criminal prosecutions against the corporation's shareholders or officers. Although books and records of a corporation ordinarily are not admissible in a criminal prosecution against its shareholders or officers without a showing that the defendants made the entries in the books or records, caused them to be made, or assented to them, a number of cases, in effect extending to close corporations the rules applicable to the admissibility of partnership books, have held that books of a close corporation are admissible against shareholders or officers without such a showing.<sup>62</sup>

An interesting Ohio case, *Standard International Corp. v. McDonald Printing Co.*,<sup>63</sup> illustrates the growing readiness of courts to protect the reasonable expectations of shareholders in close corporations, even though those expectations are not reflected in shareholders' agreements, corporate charters, or by-laws in a way that calls for protection under traditional doctrine. In that case, five of the corporation's eight shareholders constituted its board of directors. Two of the directors, who together owned slightly more than fifty per cent of the company's outstanding shares, entered into a contract to sell their shares to an outsider at \$33 per share. The other three directors were opposed to the sale, and the directors by a vote of three to two authorized the issuance of 7,000 additional shares to Walter McDonald, one of the three directors, at a price of \$37.50 per share. The company's charter contained clauses (1) waiving shareholders' pre-emptive rights and (2) providing that stock issues should be subscribed for and sold as determined by resolution adopted by a majority of the board of directors. The action of the directors in issuing the shares to McDonald was challenged on the ground that since McDonald's vote was necessary for passage of the resolution, the resolution had not received the favorable vote of a disinterested majority of directors.<sup>64</sup>

<sup>61</sup> *Id.* at 18, 60 N.W.2d at 830.

<sup>62</sup> See *Wilkes v. United States*, 80 F.2d 285 (9th Cir. 1935); *Cullen v. United States*, 2 F.2d 524 (9th Cir. 1924), cert. denied, 267 U.S. 593 (1925); *Annot.*, 154 A.L.R. 279, 282 (1945).

<sup>63</sup> 13 Ohio Op. 2d 333, 159 N.E.2d 822 (C.P. 1959).

<sup>64</sup> The directors' action could also have been challenged on the ground that directors are

The court, however, sustained the board's action, holding that the articles of incorporation are the basis for individual corporate existence and "lay the foundation and limits for corporate action . . ." <sup>65</sup> The decision undoubtedly was influenced by the fact that this was a closely held corporation and that the participants probably had contemplated that a majority of the shares would not be transferred to an outsider. <sup>66</sup> The court commented that the testimony showed that the purpose of the three directors in selling the stock to McDonald was to "perpetuate the company on the basis it had originally been set up." <sup>67</sup>

In an unusual and interesting case, <sup>68</sup> the Superior Court of New Jersey showed no hesitancy in disregarding the separate legal personalities of several corporations which had been formed to conduct a family enterprise. On the death of the founder of the business, his widow and seven children formed a partnership. A son, Anthony, who for a number of years before his father's death had managed the business, continued as general manager. Over the years, in the course of the evolution and expansion of the business, Anthony used partnership funds to organize or purchase a number of corporations, which were utilized as instrumentalities or departments of the partnership enterprise. Dissension eventually developed among the partners, and Anthony brought suit for dissolution of the partnership. In the dissolution proceedings, Arthur, one of the brothers, insisted that the family enterprises constituted a single integrated partnership operation, even though some phases of it were conducted in corporate form, and that he was entitled to be paid in full in cash for his interest and not in part by a distribution of shares in the various corporations. His reasons for taking this position were explained by the court as follows: "As a member of a partnership that

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under a fiduciary duty not to manipulate share issues for the benefit of any one group of shareholders. See *Schwab v. Schwab-Wilson Mach. Corp.*, 13 Cal. App. 2d 1, 55 P.2d 1268 (Dist. Ct. App. 1936); *Ross Transp., Inc. v. Crothers*, 185 Md. 573, 45 A.2d 267 (1946); *Elliot v. Baker*, 194 Mass. 518, 80 N.E. 450 (1907); *Dunlay v. Avenue M Garage & Repair Co.*, 253 N.Y. 275, 170 N.E. 917 (1930).

<sup>65</sup> *Standard Int'l Corp. v. McDonald Printing Co.*, 13 Ohio Op. 2d 333, 334-35, 159 N.E.2d 822, 824 (C.P. 1959).

<sup>66</sup> But for a case in which expectations of a shareholder in a close corporation were not protected, see *Gwin v. Thunderbird Motor Hotels, Inc.*, 216 Ga. 652, 119 S.E.2d 14 (1961) (holder of 50% of stock did not have 50% control in view of by-law providing for 3-man board and the holding over of board with unfriendly majority due to deadlock among shareholders).

<sup>67</sup> *Standard Int'l Corp. v. McDonald Printing Co.*, *supra* note 65, at 335, 159 N.E.2d at 824. For another case in which a court protected what it considered to be the reasonable expectations of participants in a closely held corporation, see *Thomas v. Satfield Co.*, 363 Mich. 111, 108 N.W.2d 907 (1961). There, the court commented that shareholders who, pursuant to arrangements for promoting the corporation had erected a bowling alley and leased it to the corporation, "had the burden of proving they delivered a building in accordance with the expectation of all concerned at the time the lease was executed." *Id.* at 122, 108 N.W.2d at 912.

<sup>68</sup> *Fortugno v. Hudson Manure Co.*, 51 N.J. Super. 482, 144 A.2d 207 (App. Div. 1958).

owns several corporations he has an effective voice in partnership policy and operation, but as a minority stockholder he could be over-ruled by a majority vote. Further, his minority interest in a closed family corporation does not have a market value commensurate with its actual value."<sup>69</sup> The court concluded that partnership and the corporations constituted a single enterprise,<sup>70</sup> and that as creditors or other outsiders were not involved, it could ignore the corporations' separate personalities in order to do justice among the partners. The court's order was novel. Recognizing that a forced sale of the partnership would destroy a great part of the value of the business, the court approved a proposal suggested by Arthur during the oral argument: if the other partners would agree to an appraisal of the partnership under the court's supervision and payment to Arthur of one-eighth of the valuation fixed in the appraisal, the court would so order; otherwise, it would order a liquidation by sale of all partnership assets, including those owned by the corporations.<sup>71</sup> Interestingly, the court was of the opinion that it could not directly order the remaining partners to buy out Arthur's interest.<sup>72</sup>

#### CAUTIOUS SUGGESTIONS FOR FUTURE DEVELOPMENT

As has been shown in the section of this article immediately preceding, the courts in this country are moving steadily, though slowly and often clumsily and gropingly, to develop separate rules suitable for the regulation of close corporations. Nevertheless, they need to do a great deal more.

The two principal conceptualistic barriers to judicial development of satisfactory rules for the close corporation are: (1) the principle of majority rule in corporate management, and (2) the business judgment rule. These principles, for reasons set forth in the following paragraphs, should not be applied in unqualified and indiscriminate fashion to small business corporations.<sup>73</sup>

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<sup>69</sup> *Id.* at 496, 144 A.2d at 214.

<sup>70</sup> A number of recent decisions, in recognizing that the several business organizations used in a large family enterprise were a single economic unit and treating them as a unit for certain legal purposes, have used language and reasoning reminiscent of the "enterprise entity" theory of Professor Adolf A. Berle, Jr. See, e.g., *Hall v. John S. Isaacs & Sons Farns, Inc.*, 37 Del. Ch. 530, 537-39, 146 A.2d 602, 607 (Ch. 1958); *Adolph Gottscho, Inc. v. American Marking Corp.*, 26 N.J. 229, 235, 139 A.2d 281, 284 (1958).

<sup>71</sup> "That the alternative granted is novel does not deter us, for it is 'no objection to the exercise of jurisdiction that, in the ever-changing phases of social relations, a new case is presented and new features of wrong are involved.'" *Fortugno v. Hudson Manure Co.*, 51 N.J. Super. 482, 505, 144 A.2d 207, 219 (Super. Ct. 1958).

<sup>72</sup> *Ibid.* *Weissman v. Henkin*, 154 Pa. Super. 12, 34 A.2d 907 (Super. Ct. 1943), was cited as authority for this proposition.

<sup>73</sup> Many of the ideas set forth in the next few paragraphs were first advanced by the author in *O'Neal, Oppugnancy and Oppression in Close Corporations: Remedies in America and in Britain*, 1 *Boston Coll. Indus. & Comm. L. Rev.* 1 (1959).

The principle of majority rule is in traditional legal thought a firmly established attribute of the corporate form. Apparently without close examination, courts have accorded the principle of majority rule the same sanctity in corporate enterprises, including small businesses, that it enjoys in the political world. Yet many participants in closely-held corporations are "little people," unsophisticated in business and financial matters. Not uncommonly a participant in a closely-held enterprise invests all his assets in the business with an expectation, often reasonable under the circumstances even in the absence of express contract, that he will be a key employee in the company and will have a voice in business decisions. Thus, when courts apply the principle of majority rule in close corporations, they often disappoint the reasonable expectations of the participants.

The indiscriminate application of the business judgment rule to sustain action of directors in close corporations is also subject to criticism. That rule seems to be grounded on the following ideas: (1) shareholders have selected the directors to manage the business, and courts are not justified in substituting their judgment for that of managers selected by the owners of the business; (2) directors' decisions are based on complex business considerations and courts are simply not qualified to make those decisions and should not interfere with them in the absence of a clear abuse of discretion; and (3) a heavy burden should be placed on complaining shareholders to discourage "strike suits" and frivolous litigation.

These justifications for the business judgment rule, however, do not apply in all their vigor in a close corporation. Courts may well consider intervention to protect minority shareholders in a close corporation against oppressive action by the directors (unfair dividend policies, for example), even though fraud, bad faith or, for that matter, clear unreasonableness on the part of the directors cannot be shown. Participants in a close corporation do not usually think of themselves as delegating management of their corporation to an independent board of directors; a board is often viewed only as a legal formality. Owners and managers, insofar as the participants look into the future, are to be the same. Minority shareholders expect to share in management.

It hardly seems necessary in all cases to say, as the courts so often have said in effect, that when a person becomes a shareholder in a corporation he assumes a status with all of its legally built-in liabilities, irrespective of his and his associates' intentions and expectations. Further, in a close corporation, where the business considerations on which directors' decisions are based are likely to be somewhat less intricate than in public-issue corporations and the directors making the decisions

are likely to be somewhat less knowledgeable, judges have less reason to show an unquestioning deference to decisions of a directorate. Finally, the great practical danger of a too-ready judicial interference with public-issue corporations, the danger of encouraging "strike suits," is not present, at least not in the same degree.

The courts have been particularly timid and lacking in resourcefulness in evolving decrees to meet typical close corporation problems, *i.e.*, decrees that will adequately protect oppressed minority shareholders. This judicial timidity probably could be overcome by a statute such as Section 12-22.23 of the South Carolina Business Corporations Act,<sup>74</sup> which expressly gives the courts almost unfettered discretion to impose upon the parties to a dispute in a close corporation whatever settlement the court considers just and equitable. Perhaps a statute of that kind could even be improved by providing for hearings in chambers, thus avoiding publicity which might adversely affect the corporation or the shareholders.<sup>75</sup>

Now for a few comments on recent legislation dealing with shareholders' agreements and other arrangements that take from the directors powers normally within their province or otherwise depart from the traditional pattern of corporation management. These statutes are part of a steady movement that has been occurring in the regulation of the relations of participants in close corporations. Yet these statutes typically limit this newly-granted contractual freedom in two important respects.

One limitation that is commonly imposed is a requirement that control arrangements departing from the traditional pattern of corporation management must be inserted in a particular document in order to be valid. For instance, in New York high quorum and high vote requirements for shareholder and director action<sup>76</sup> or an arrangement limiting the powers of the directors<sup>77</sup> must be inserted in the certificate of incorporation. Similarly, the South Carolina statute provides that a shareholders' agreement that limits or restricts the powers of the directors must be set forth, or be referred to, in the articles of incorporation.<sup>78</sup>

The policy underlying such requirements is not clear. While inclusion of control arrangements in the corporation's charter might provide notice of the provisions in some cases to those dealing with the corporation, it is difficult to see why such persons would be concerned with the cor-

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<sup>74</sup> See notes 38-41 *supra* and accompanying text.

<sup>75</sup> The Report of the Departmental Committee on Law Amendment, (Northern Ireland), Cmd. 393, at 11, suggests rules of court providing for hearings in chambers in applications under § 210 of the English Company Act, *supra* note 40.

<sup>76</sup> N.Y. Bus. Corp. Law §§ 616, 709 (1963).

<sup>77</sup> N.Y. Bus. Corp. Law § 620 (1963).

<sup>78</sup> S.C. Code Ann. § 12-16.22(b)(1) (Supp. 1964).

poration's internal operations. After all, persons dealing with a corporation who are unaware of high vote requirements or other special control arrangements are protected by the doctrine of apparent authority, which binds the corporation to contracts and other transactions apparently within the authority of agents representing the corporation.

Statutes directing the inclusion in the corporation's charter of specified kinds of control arrangements may provide a clear guide for an experienced member of the corporate bar to follow in tailoring the corporate form of business to the needs of his clients. Unfortunately, general practitioners serving small businessmen often do not realize that some shareholders' control agreements must be included in the corporation's charter to be effective. If anyone doubts that lawyers in states with such a requirement often overlook it, an examination of the reported cases will remove those doubts.

A general practitioner often concludes that the simplest and most effective method of implementing the shareholders' business bargain on control of the corporation is by a carefully drafted written agreement signed by all interested parties. Great injustice usually results in these situations if some of the parties are allowed to "welch" on their deal. Sometimes a court, undoubtedly swayed by the prospect of such injustices, finds a way to enforce an agreement even though it is not in the prescribed form.<sup>79</sup>

A second limitation that some statutes impose on shareholders' voting agreements is to restrict their validity to a ten-year period.<sup>80</sup> Apparently this limitation is based on the precedent contained in statutes dealing with voting trusts, which statutes in the past have typically limited voting trusts to ten years.<sup>81</sup> Whatever the soundness of a policy imposing a time limitation on the term of a voting trust, such a limitation on the term of an agreement among shareholders in a close corporation appears highly questionable.

When a ten-year control agreement expires, minority shareholders again become vulnerable to the principle of majority rule and are thrown upon the often not-so-tender mercies of majority shareholders.<sup>82</sup> The

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<sup>79</sup> See, e.g., *Katcher v. Ohsman*, 26 N.J. Super. 28, 97 A.2d 180 (Super. Ct. 1953).

<sup>80</sup> E.g., S.C. Code Ann. § 12-16.15 (Supp. 1964).

<sup>81</sup> The Reporter's Note to § 12-16.15 [§ 6.15 of the Draft Statute] provides: "Finally, so as to place the voting trust and pooling agreement on a parity, the proposed section provides that voting agreements should be limited to ten years, subject to extension." Draft Version, South Carolina Business Corporation Act of 1962 at 106. It is interesting to note that a number of states now validate voting trusts for periods of time longer than ten years. See e.g., Cal. Corp. Code § 2231; Minn. Stat. Ann. § 301.27 (1947); Nev. Rev. Stat. § 78.365 (1957).

<sup>82</sup> For a documented story of the oppression of minority shareholders in small business enterprises see O'Neal & Derwin, *Expulsion and Oppression of Business Associates* (1961).

stake of minority shareholders in the enterprise will then probably be greater in dollar value than at the time of the making of the contract, and their chance of making a satisfactory business connection elsewhere will probably be less.

Is it too bold to suggest that perhaps businessmen in a close corporation should be given the same freedom to contract among themselves in respect to the corporation's management that businessmen in general are given to contract with each other? Are there really sound policy reasons for requiring a shareholders' agreement to be embodied in the charter or for limiting its term to ten years? A shareholders' control agreement in a close corporation is often designed to protect the underdog—the minority shareholder—and he invests in the enterprise on the faith of the security he thinks the agreement provides. Should majority shareholders be permitted to "welch" on their deal and assume almost unrestricted control over the corporations' affairs just because the lawyer serving the parties did not embody the agreement in the charter? To this writer, the answer to each of these questions is "No." At least that clearly is the answer if all shareholders in the corporation are parties to the agreement. If some of the shareholders are not parties, perhaps that answer has to be given somewhat more cautiously; but even then, no reason is apparent for permitting parties to a carefully-bargained shareholders' agreement to repudiate their promises with impunity on the ground that the agreement may be prejudicial to noncontracting parties when those persons are not in court complaining of its alleged adverse effect on them. In this area of the law, a number of sacred cows are overdue for slaughter.

#### APPENDIX

Fla. Stat. Ann. §§ 608.0100-.0106 (Supp. 1964):

##### Section 608.0100 Scope; definitions

(1) The provisions of this act shall extend to all close corporations, but shall be deemed permissive and not mandatory; provided, however, that this act shall have no application to any close corporation in existence on September 1, 1963, hereof unless such previously existing close corporation shall elect to bring itself within the provisions of this act by written consent of the owners of a majority of the voting stock.

(2) As used herein, closed corporations means a corporation for profit whose shares of stock are not generally traded in the markets maintained by securities dealers or brokers.

(3) Whenever applicable, the provisions of this act shall apply notwithstanding any provision of this act to the contrary.

(4) Wherever used herein, unless otherwise stated, stockholders shall mean stockholder if there be only one stockholder of a corporation.

**Section 608.0101 Acquisition of all the shares of stock by limited number of persons**

(1) The existence of a corporation, hereafter or heretofore formed under the laws of this state, shall in no respect be deemed impaired by the acquisition of all the shares of stock of such corporation by one person or by two persons, nor shall the corporation, by such acquisition, be deemed not to possess any managerial boards or bodies or any capacities, powers or authority which it would have possessed with three or more stockholders, nor shall the corporation, upon such acquisition, be deemed to have become dormant, inactive or incapable of acting as a corporation.

(2) The acquisition, heretofore or hereafter, of all of the shares of stock of a corporation by one person or by two persons is hereby declared to violate no policy or provision of the laws of this state.

**Section 608.0102 Corporation management by stockholders**

The articles of incorporation of a close corporation may provide that the business of the corporation shall be managed by the stockholders of the corporation rather than by a board of directors, provided that there be not less than three stockholders; and, if the articles of incorporation provide as aforesaid, the following provisions shall apply:

(1) Wherever the context requires, the stockholders of such close corporation shall be deemed directors of such corporation for purposes of applying the provisions of part I, chapter 608.

(2) The stockholders of such close corporation shall be subject to the liabilities imposed by part I, chapter 608, for action taken by directors.

(3) Any action required or permitted by part I, chapter 608, to be taken by the directors of a corporation may be taken by action of the stockholders of such close corporation at a meeting of the stockholders or as provided in § 608.0104.

**Section 608.0103 Conduct of business without meeting by board of directors or executive committee**

If the business of a close corporation is managed by a board of directors, action taken by the directors or the members of an executive committee of the directors without a meeting shall nevertheless be board or

committee action if written consent to the action in question is signed by all the directors or members of the committee, as the case may be, and filed with the minutes of the proceedings of the board or committee, whether done before or after the action so taken.

**Section 608.0104 Conduct of business without meeting by stockholders**

Any action of the stockholders of a close corporation may be taken without a meeting if consent in writing, setting forth the action so taken, shall be signed by all the persons who would be entitled to vote upon such action at a meeting and filed with the secretary of the corporation as part of the corporate records. Such consent shall have the same force and effect as a unanimous vote of the stockholders, and may be stated as such in any certificate or document filed with the secretary of state under this chapter.

**Section 608.0105 Written agreements as to conduct of certain affairs of corporation**

(1) The stockholders of a close corporation may enter into a written agreement, embodied in the articles of incorporation or bylaws of the corporation, or in a side agreement in writing and signed by all the parties thereto, relating to any phase of the affairs of the corporation, including, but not limited to, the following:

- (a) Management of the business of the corporation.
- (b) Declaration and payment of dividends or division of profits.
- (c) Who shall be officers or directors, or both, of the corporation.
- (d) Restrictions on transfer of stock.
- (e) Voting requirements, including the requirements of unanimous voting of stockholders or directors.
- (f) Employment of stockholders by the corporation.
- (g) Arbitration of issues as to which the stockholders are deadlocked in voting powers or as to which the directors are deadlocked and the stockholders are unable to break the deadlock.

(2) No written agreement to which stockholders of a close corporation have actually assented, whether embodied in the charter or bylaws of the corporation or in any side agreement in writing and signed by all the parties thereto, and which relates to any phase of the affairs of the corporation, whether to the management of its business or division of its profits or otherwise, shall be invalid as between the parties thereto, on the ground that it is an attempt by the parties thereto to treat the corporation as if it were a partnership or to arrange their relationships in a manner that would be appropriate only between partners.

(3) If the business of a close corporation is managed by a board of directors, an agreement among all or less than all of the stockholders, whether solely among themselves or between one or more of them and a party who is not a stockholder, is not invalid, as among the parties thereto, on the ground that it so relates to the conduct of the affairs of the corporation as to interfere with the discretion of the board of directors, but the making of such an agreement shall impose upon the stockholders who are parties thereto the liability for managerial acts that is imposed by the laws of this state upon directors.

**Section 608.0106 Director**

The stockholders of a close corporation entitled to elect a director of such corporation may at any time remove such director, with or without cause, by like action of the stockholders as required for the election of such director, absent a contrary provision by agreement or in the bylaws or articles of incorporation of the corporation.

**Section 608.0107 Dissolution; appointment of receiver or trustee**

The circuit court, sitting in chancery, may entertain a petition of any stockholder for involuntary dissolution of any close corporation and, at the hearing, may appoint a receiver or trustee of the corporation and order it dissolved, pursuant to the procedure provided in § 608.29, when it is made to appear:

1. That the directors of the corporation are deadlocked in the management of the corporate affairs and the stockholders are unable to break the deadlock, or
2. That the stockholders are deadlocked in voting power; and
3. Arbitration or any other remedy provided in any written agreement of the stockholders upon deadlock of the directors or stockholders has failed.