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# PROPOSING A NEW YORK "CLOSE CORPORATION LAW"

NORMAN WINER

## I. INTRODUCTION

The purpose of this article is to contribute to the fashioning of an improved and realistic law for close corporations.

Despite various revisions of our corporate laws since the general acts opened the floodgates to closely held enterprises, no attempt has been made to formulate legislation to fit the characteristics which obviously distinguish the close corporation from the public one. The same law applies to the two incorporated "partners" who invest \$3,000 and to the 400,000 investors who own readily marketable securities in an enterprise with total assets of \$2,000,000,000.

From application of these same concepts, the close corporation suffers. Stockholders' agreements, in which attempt is made to adjust the structure desired by the stockholders to the statutory forms, abound in clauses of needless complexity, illegality, and unenforceability.

The courts, driven to vary the general rules, defensively characterize the close corporation as a "chartered"<sup>1</sup> or "incorporated"<sup>2</sup> partnership and sometimes adopt such hedges as that of Chief Judge Cullen: "Such corporations were little more (though not the same as) than chartered partnerships."<sup>3</sup>

## II. THE TYPE OF LAW

The laws for public corporations are devised for investors as well as third parties. The state must protect those who buy into enterprises of which they can have no detailed knowledge and must protect those who own such shares without any control over the use of their funds.

In close corporations, the need to protect the investor is quite different. He, as does the partner, picks his associates and generally is one of those in control of his money. On the other hand, he is in a position where he must trust each fellow-stockholder, something unnecessary and unjustified in a public corporation.

In large corporations, securities are readily marketable; it is necessary for the close incorporator to have a way out; yet, it is suggested, that way should

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<sup>1</sup>Ripin v. United States Woven Label Co., 205 N. Y. 442, 447, 98 N. E. 855, 856 (1912).

<sup>2</sup>Cuppy v. Ward, 187 App. Div. 625, 639, 176 N. Y. Supp. 233, 243 (1st Dep't 1919) (dissenting opinion of Shearn, J.), *aff'd*, 227 N. Y. 603, 125 N. E. 915 (1919).

<sup>3</sup>See note 1 *supra*.

not be to compel liquidation at the expense of the other stockholders as in a partnership.

Again, because of the limited assets at risk, the state has the same interest in protecting those who trade with a close corporation as with a public corporation, and the same interest in their tort victims. The assets must not be distributed or dissipated at the expense of the third parties.

In short, in many respects, the best law for close corporations is similar to, and in many respects it differs from, each other existing law for associations of capital and associations of persons. Consequently, it appears most feasible to frame a separate law.

### III. DEFINITION

The usual characteristics of the close corporation are: (1) the stockholders are few; (2) they know one another well; (3) most or all of them are active; (4) each of them assumes some affirmative obligations; (5) there is no ready market for their shares; and (6) the identity of the other shareholders is important to each of them.

There are many corporations which lack one or more of the foregoing, but are, nevertheless, close corporations. From the practical point of view, it seems best to start with one-man corporations, an institution which we, as distinguished from many other countries, recognize,<sup>4</sup> and to limit the maximum number of stockholders; normally, with few stockholders, the corporation will possess most of the above characteristics.

In England<sup>5</sup> and Belgium<sup>6</sup> "private" and limited responsibility companies come under different statutes if stockholders do not exceed fifty, if the transfer of shares is restricted and if public subscription is renounced. These are not our close corporations; fifty stockholders cannot be intimate; restriction on transfer is a common attribute but not an inevitable one; public subscription is wholly theoretical.

Our common situations are: two or three men pool their resources and ability; one man buys a parcel of realty or his success has been such that he can remove part of his capital from the business and would like to put it away safely; one man finances two or three others; a merchandising close

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<sup>4</sup>A discussion of the extent to which a body of law has developed for one man corporations may be read in Fuller, *The Incorporated Individual: A Study of the One-Man Company* (1938) 51 HARV. L. REV. 1373. See England: Companies Act, 1929, 19 & 20 GEO. 5, c. 23, § 28; Belgium: Law of July 9, 1935, *loi modifiant la loi sur les sociétés coopératives et instituant des sociétés de personnes à responsabilité limitée* (MONTR. 10 Juillet) Art. 114<sup>bis</sup>; France: Law of March 7, 1925. *Tendant à instituer des sociétés à responsabilité limitée* (JOURNAL OFF. DU 7 MARS 1925), Art. 5.

<sup>5</sup>England: Companies Act, 1929, 19 & 20 GEO. 5, c. 23, § 26.

<sup>6</sup>Belgium: Arts. 114 *bis*, 114<sup>bis</sup>.

corporation buys a store site on which it prefers not to assume the mortgage; a mercantile close corporation wishes to venture into manufacturing; a real estate close corporation puts its several properties at separate risk or divides its management operations from its owned parcels, *etc.*

For the purposes of the present discussion, a close corporation is one with one to five ultimate stockholders, although undoubtedly close corporations often have more. Generally, if there are three original incorporators, and two die, leaving four heirs each, the original intimacy, sometimes even acquaintance, is lost, and the heirs rarely participate in the business; such a corporation ceases to be close in the sense here used. So, too, when a single corporation with 1,000 stockholders is the sole stockholder in a subsidiary, the latter is not a close corporation. When, on the other hand, five stockholders, either through a holding corporation or separately, own several corporations, each of them is close within the definition here suggested.

#### IV. CONTROL

In the publicly owned corporation, the possession of control is of no moment to those who merely seek a remunerative investment in the shares of that corporation. In their "own business" it is vital. The freedom afforded by the Partnership Law to partners to agree among themselves as to who will control<sup>7</sup> is desirable for close corporations.

The parties frequently desire a complex division of power. The moneyman insists, at least, on veto power with respect to salaries and directive power with respect to dividends. The merchandiser wants his own styling and selling methods. The investor-employee wants his job and some voice in all corporate decisions. Corporate theory places all these matters, in some or all of their aspects, within the province of the board of directors, and it recognizes no right in a minority of the board ever to outvote the majority; nor does it brook the intervention of outsiders to determine corporate policy whether or not the board is deadlocked. In short, the flexibility desired is not legally obtainable.

##### A. Election of Directors

The New York Stock Corporation Law gives latitude in the selection of the board. The stockholders may assure a fixed number of directors by forbidding change in number without unanimous consent.<sup>8</sup> They may assure the identity of the directorate by agreeing to vote for one another.<sup>9</sup> By classifying stock, they may assure each stockholder the power to name a

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<sup>7</sup>N. Y. PARTNERSHIP LAW 40. See *King v. Sarria*, 69 N. Y. 24 (1877).

<sup>8</sup>See note 1 *supra*.

<sup>9</sup>See *Manson v. Curtis*, 223 N. Y. 313, 119 N. E. 559 (1918); *Clark v. Dodge*, 269 N. Y. 410, 199 N. E. 641 (1936).

given number of directors.<sup>10</sup> An aberration prevents provision for election of directors by any number other than a plurality of those voting.<sup>11</sup> Cumulative voting<sup>12</sup> will usually insure some representation on the board.

Assuming, then, that the draftsman has not overlooked possible traps, he can, under existing law, assure the stockholders as to the personnel of the board. One type of pitfall is the opportunity to increase stock. If power depends upon a percentage of voting shares, the wealthy stockholders may frequently unbalance a carefully formulated plan by voting a stock increase,<sup>13</sup> as to which the poor ones may be unable to exercise their pre-emptive rights.<sup>14</sup> Where a small interest holds the balance of power, a poor stockholder may be unable to match the extravagant bid of the rich to buy that stock. These gaps should be closed by forbidding stock increase without unanimous consent, unless the stockholders have, in advance, affirmatively agreed otherwise, and by extending pre-emptive rights to the latter case. While the latter is obviously not a perfect remedy, since (1) the amount will not be unlimited, and, as will appear below, (2) an ever-available right to dissolve is suggested, the combination gives fair assurance against overpayment for the stock. The possibility of majority agreements to effect control<sup>15</sup> should be eliminated.

### B. Functions of the Board

The board, however, is generally but a superfluous complication. On the one hand, five stockholders may well manage their own affairs. On the other, once they create a board, the stockholders are shackled.<sup>16</sup>

For example, the board may be well-constituted to prevent the majority stockholder from dominating it. But where it is intended that he be sole

<sup>10</sup>N. Y. STOCK CORPORATION LAW § 51.

<sup>11</sup>Matter of Boulevard Theatre & Realty Co., 195 App. Div. 518, 186 N. Y. Supp. 430 (1st Dep't 1921), *aff'd*, 231 N. Y. 615, 132 N. E. 910 (1921). The distinction between preserving the number of and the identical directors may be a substantial one. The ground in the opinion, however, that the statute says the number of directors "may" be increased, but directors "shall" be elected by a plurality, is not convincing, as neither thought could have been expressed the other way. See N. Y. STOCK CORPORATION LAW §§ 35, 55.

<sup>12</sup>N. Y. STOCK CORPORATION LAW § 49.

<sup>13</sup>Under existing law it is not clear whether the issuance of shares, authorized but unissued, is for the stockholders or the directors, 11 FLETCHER, CYCLOPEDIA OF CORPORATIONS (Perm. ed. 1932) pp. 286-287. A newly authorized issue must be voted by half or two-thirds of the shares, according to circumstances. N. Y. STOCK CORPORATION LAW § 37. A typical example of such abuse is found in *Witherbee v. Bowles*, 201 N. Y. 427, 95 N. E. 27 (1911).

<sup>14</sup>N. Y. STOCK CORPORATION LAW § 39.

<sup>15</sup>See part V, section E, *infra*.

<sup>16</sup>This aspect, it seems, has been in the minds of previous writers, who have not gone beyond the stage of "there ought to be a law." Weiner, *Legislative Recognition of the Close Corporation* (1929) 27 MICH. L. REV. 273; 2 ROERLICH, LAW AND PRACTICE IN CORPORATE CONTROL (1933) 215.

determiner of dividend policies, but not of other action, the board generally cannot be adapted to both purposes.

A brief review of the authorities on this subject may prove helpful.

Frequently, it is of great consequence to one stockholder that he maintain his prestige in his field by being president of the new corporation he joins. How can he assure himself of that position in view of Section 60 of the Stock Corporation Law, which provides that the directors, at their pleasure, may remove any officer or employee?<sup>17</sup> Unless he controls the board, the Appellate Division, First Department, has taken the view that there is no way. In 1901, in *Flaherty v. Cary*,<sup>18</sup> at least two justices, in concurring opinions, believed such an impingement upon the board's powers was against public policy. In 1919, the court so held, three to two, where the parties to the agreement were the only two stockholders;<sup>19</sup> the majority intimated that such an agreement at the inception of the corporation might have been valid, but that an existing corporation could not later be converted into an "incorporated partnership." The distinction is not reassuring, particularly since, in 1934, the same court held invalid such an agreement made apparently at the inception of the corporation.<sup>20</sup>

Since those decisions, however, the Court of Appeals has gone at least so far as to hold that an agreement to keep in office is not *ipso facto* unenforceable. In *Clark v. Dodge*,<sup>21</sup> the court, after stating that such an agreement would not be enforced in the face of infidelity by the officer,<sup>22</sup> upheld an agreement to continue Clark in office as long as "faithful, efficient and competent" for that "could harm nobody" and "the invasion of the powers of the directorate," if any, "is so slight as to be negligible; and certainly there is no damage suffered by or threatened to anybody."<sup>23</sup>

In what position does this leave counsel to advise "Clark" and "Dodge"

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<sup>17</sup>The removed officer can doubtless recover his damages for breach of the contract. *In re Paramount Publix Corp.*, 90 F. (2d) 441 (C. C. A. 2d, 1937).

<sup>18</sup>62 App. Div. 116, 70 N. Y. Supp. 951 (1st Dep't 1901), *aff'd*, 174 N. Y. 550, 67 N. E. 1082 (1903).

<sup>19</sup>*Cuppy v. Ward*, 187 App. Div. 625, 176 N. Y. Supp. 233 (1st Dep't 1919), *aff'd*, 227 N. Y. 603, 125 N. E. 915 (1919). No inferences may be drawn from the memorandum affirmance of the Court of Appeals in view of the question presented as to the internal affairs of a foreign corporation.

<sup>20</sup>*Matter of Allied Fruit & Extract Co., Inc.*, 243 App. Div. 52, 276 N. Y. Supp. 153 (1st Dep't 1934), *motion for leave to appeal denied*, 266 N. Y. 1 v (1934).

<sup>21</sup>269 N. Y. 410, 199 N. E. 641 (1936).

<sup>22</sup>*Fells v. Katz*, 256 N. Y. 67, 175 N. E. 516 (1931).

<sup>23</sup>There were other terms in the agreement, including an agreement that one stockholder would vote for the other as director, that plaintiff, owning twenty-five per cent of the stock, should receive twenty-five per cent of the "net income" (construed as net earnings after reserves, by the court), and that no unreasonable salaries would be paid. These, of course, are no invasion of directors' powers.

at the time they make the agreement or at the time that "Dodge" concludes "Clark" must go? Suppose "Clark" is faithful, but "Dodge" concludes either (1) that he had originally misjudged "Clark" and that "Clark" was neither efficient nor competent or (2) that "Clark" had originally been faithful, efficient, and competent but because of age, illness, or other causes retained only the virtue of faithfulness. Does the agreement become invalid because "Dodge" so concludes, or only when he proves to the court that he so concludes, or when he proves to the court that a reasonable man would so conclude? Because of the intimacy of the relationship and the importance of the business to the stockholders, it is frequently hard on "Dodge" to force him to continue "Clark" in office if "Dodge" honestly believes "Clark" inefficient, regardless of the ultimate fact of the matter.

Germany,<sup>24</sup> Belgium,<sup>25</sup> and France<sup>26</sup> hold such agreements binding except for "*wichtige Gründe*" or "*motifs graves*" meaning gross neglect, dishonesty, incapacity.

That appears the preferable pattern. Where "Clark" is a stockholder we have the example *par excellence* of an agency coupled with an interest. A party found dishonest or incapacitated could not enforce the agreement. Any other could, subject only to the right to dissolution. The indestructible right to dissolve is discussed below; but as long as the corporation continues, the officer's contract should be specifically enforceable. Impingement upon the functions of the board is merely a verbal rationalization. No public interest is affected; the only ones involved are the parties to a good or poor bargain, and "Clark" may have sacrificed much and have invested all he had in an effort to build a business for himself and "Dodge."

Secondly, it is frequently essential to the formation of a successful corporation that one or more stockholders be given dominion over dividends. In 1881, the Court of Appeals held in *Lorillard v. Clyde*<sup>27</sup> that an agreement to pay a dividend of seven per cent was not illegal; but it added the *dictum* that it might be unenforceable.<sup>28</sup> The Appellate Division, First Department, said in 1914 that an agreement among five sole stockholders that "profit shall be distributed in a certain way, irrespective of the stock held by

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<sup>24</sup>*Gesetz betr. die Gesellschaften mit beschränkter Haftung, vom 20 April, 1892, § 38.* In later modifications of this statute, section numbers have been changed, and allowance must be made for numbering of these sections.

<sup>25</sup>Belgium: Art. 114<sup>15</sup>.

<sup>26</sup>France: Art. 24.

<sup>27</sup>86 N. Y. 384 (1881).

<sup>28</sup>Andrews, J., wrote [*Id.* at 389]: "An agreement providing for the details of management made in advance, might not be binding upon the trustees of the corporation when organized, but such agreement is not illegal."

them, would be void as against public policy."<sup>29</sup> In 1919, two justices of the same court thought that such an agreement between two who were the only stockholders was valid.<sup>30</sup> The Appellate Division, Second Department, in compelling payment of dividends withheld apparently in bad faith, said that if creditors were unaffected "there is no reason why the exercise of the power and discretion of the directors cannot be controlled by valid agreement between themselves [the stockholders]."<sup>31</sup> In the following year, that court refused to enforce such an agreement; while deciding on other grounds, it stated its doubts as to the enforceability of the stockholders' agreement, as against the directors, barring extreme circumstances.<sup>32</sup> To put it mildly, it is somewhat difficult for counsel to advise on the validity of such an agreement.

Thirdly, there are the common provisions in case of deadlock. Frequently, as a prerequisite to the formation of a corporation, the board must be so divided as virtually to promise an impasse in case of crisis. Arbitration, should the directors divide equally, is a feasible solution, if legal. Today, however, it is not legal or enforceable because: (1) the arbitration statute does not include an award to determine policy<sup>33</sup> and (2) corporate theory prevents abdication by the board.<sup>34</sup> Again, in a recent case, where several parcels of realty were owned by a close corporation, internecine antagonism, abetted by provisions perfectly adapted for a deadlock, paralyzed the corporation. Partition, sale, dissolution, with real estate prices depressed, were impractical; continued operation was essential. Complete control was, therefore, entrusted to a stranger. Was that legal?

### C. Lack of Realism in Theory of Board Control

The fundamental error is the notion that since a board acting for 400,000 stockholders should always be free to exercise uncontrolled judgment, the same applies in a close corporation.

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<sup>29</sup>Abbott v. Harbeson Textile Co., 162 App. Div. 405, 410, 147 N. Y. Supp. 1031, 1035 (1st Dep't 1914).

<sup>30</sup>Cuppy v. Ward, 187 App. Div. 625, 641, 176 N. Y. Supp. 233, 239 (1st Dep't 1919) (dissenting opinion), *aff'd*, 227 N. Y. 603, 125 N. E. 915 (1919).

<sup>31</sup>Kassell v. Empire Tinware Co. *et al.*, 178 App. Div. 176, 164 N. Y. Supp. 1033 (2d Dep't 1917).

<sup>32</sup>The case, *Dejonge v. Zentgraf*, 182 App. Div. 43, 169 N. Y. Supp. 377 (2d Dep't 1918), was decided on the ground that the contract did not explicitly require payment of the dividends, and the remarks summarized here in the text are *dicta*.

<sup>33</sup>N. Y. Civ. Prac. Act § 1448 makes arbitrable such controversies as "may be the subject of an action." For reasons already noted, these agreements do not seem to be such. *Matter of Stern*, 285 N. Y. 239, 33 N. E. (2d) 689 (1941); *Benedict v. Limited Editions Club, Inc.*, — App. Div. —, 39 N. Y. S. (2d) 852 (1st Dep't 1943).

<sup>34</sup>In *Matter of Allied Fruit & Extract Co., Inc.*, 243 App. Div. 52, 276 N. Y. Supp. 153 (1st Dep't 1934), *motion for leave to appeal denied*, 266 N. Y. 1v (1934), such an agreement was held unenforceable.

Eliminating the board makes the error clearer. Frequently, it is convenient to have a board, to leave certain stockholders without a voice in management. But, if we were to eliminate the board, we could readily perceive that the stockholders, as "partners," might bind themselves to give one or another permanent control of one aspect or another of the corporation's affairs. The same should apply to a close corporation whether or not it has a board.

Various continental laws, specially devised for smaller corporations,<sup>35</sup> make the board optional. In Belgium, the "*commissaires de surveillance*" need not be elected by corporations with five or fewer stockholders;<sup>36</sup> in France, the "*conseil de surveillance*" may be dispensed with in corporations with twenty or fewer stockholders;<sup>37</sup> in Germany, an *Aufsichtsrath* is never necessary;<sup>38</sup> in England, directors need not be elected by a private company, which may have up to fifty stockholders.<sup>39</sup>

#### D. Stockholders' Voting Rights

There remains, despite the proposed freedom in agreement, justification for the corporate rather than the partnership form. In legal theory, as well as in factual relations, the emphasis in corporations is upon the share of the net worth owned by each stockholder in determining his proportionate voting rights; in partnerships, the emphasis is upon the individuals, despite differences in shares of the proprietorship. In continental laws, the hybrid nature of the close corporation is frequently given expression by providing that a-vote-a-share is the primary method for making decisions, but that in some instances, usually capital increase or other structural change, the vote must carry by a preponderance of stockholders as well as of shares.<sup>40</sup>

The virtue of this method is in increasing minority veto power so as to prevent those who hold a preponderant financial interest from riding roughshod over an aggregate membership, which, by its nature, is a cross between a personal association and an association of capital. As such, it is a method of preserving minority strength, but not an aid in determining corporate policy or action.

The basic difference between the personal and the share vote, however, is

<sup>35</sup>At least Austria, Belgium, Bulgaria, England, France, Germany, Luxembourg, and Poland have such laws.

<sup>36</sup>Belgium: Art. 114<sup>20</sup>.

<sup>37</sup>France: Art. 32.

<sup>38</sup>Germany: § 52.

<sup>39</sup>England: Companies Act, 1929, 19 & 20 GEO. 5, c. 23 § 139.

<sup>40</sup>France: Arts. 27-28; Belgium Art. 114<sup>21</sup> and various instances throughout the statute. COPPER-ROYER SOCIÉTÉS À RESPONSABILITÉ LIMITÉE EN DROIT FRANÇAIS (1931) 82.

a reason for differentiating close corporations and partnerships. Where any residual power, undisposed of by agreement, remains in the stockholders, vote by shares is the natural intent of the incorporators.

#### *E. The Recommended Remedy*

Since the present board system, with its rigid theory that the board determines policy, ordinarily prevents legal and enforceable agreements assuring (1) that authority may reside where the stockholders want to place it, (2) that profits will be distributed as the parties desire, (3) that there will be a solution in the event of impasse, and since such a result lacks realism with respect to close corporations, it is suggested that the theory be supplanted.

The public is not affected by the internal agreements of the close corporation. The remedy recommended is: (1) eliminate the traps which threaten relative ownership and voting power which have been stabilized by agreement; (2) give each corporation the choice of having or dispensing with a board, and, in either case, permit the stockholders, by unanimous agreement, to possess the powers normally resident in the board; and, (3) provide a summary form of specific enforcement of such agreements.

### V. FIDUCIARY RELATIONSHIP

It is in the relationship of the stockholders to one another that corporate concepts are least fitting. For one of 400,000 stockholders to owe personal duties to another whom he has never met, simply because both own securities in one company, is, by today's standards, stretching a point. For three stockholders, seeing one another daily, planning their business together hourly, not to owe fiduciary obligations, is so incongruous, that it clearly appears not to be the law. General statements that stockholders are trustees for one another only when they misuse majority control, when they usurp the functions of the board,<sup>41</sup> or only in questions of management<sup>42</sup> do not apply to close corporations.

#### *A. The Interests of the Corporation*

Since *Farmers' Loan & Trust Co. v. New York and Northern Railway Co.*,<sup>43</sup> it has been clear that if the majority stockholder of a corporation, through control of it, exercises the corporate powers to the advantage of the stockholder and to the detriment of the corporation, that stockholder is ac-

<sup>41</sup>*Blaustein v. Pan American P. & T. Co.*, 263 App. Div. 97, 119, 31 N. Y. S. (2d) 934, 956 (1st Dep't 1941); *Levy v. American Beverage Corp.*, 265 App. Div. 208, 216, — N. Y. S. (2d) —, — (1st Dep't 1942).

<sup>42</sup>*E. g.*, *Gerdes v. Reynolds*, 28 N. Y. S. (2d) 622, 650 (Sup. Ct. 1941).

<sup>43</sup>150 N. Y. 410, 44 N. E. 1043 (1896). See also *Gamble v. Queens County Water Co.*, 123 N. Y. 91, 98, 25 N. E. 201, 202 (1890).

countable to the corporation. Doubtless, a minority stockholder in position so to use the corporation would be similarly liable.

In close corporations, with reference to the corporate property, we may go beyond the element of control. The case of *Meinhard v. Salmon*<sup>44</sup> has been cited by the Court of Appeals for the existence of a fiduciary relationship among the stockholders of a close corporation. It affords an excellent example of the difference between close and public corporations. Meinhard and Salmon, as co-adventurers, owned a leasehold. Without any fraud,<sup>45</sup> Salmon, the manager, during the term, procured in his own behalf an extension of the lease, together with a lease on adjoining property, to follow the adventurers' lease period. The court held that "by virtue of his agency" he was "charged . . . with the duty of disclosure";<sup>46</sup> the "more obviously"<sup>47</sup> because he was the manager of the adventure.

Judge Cardozo doubtless chose his words carefully. Perhaps it was more obvious that with Meinhard relying on Salmon, as manager, the latter should have disclosed his purpose; but Judge Cardozo probably would have found the less obvious true too, that Meinhard, sitting back while Salmon worked, would have been charged with the duty to disclose a like purpose.

Had Meinhard and Salmon been stockholders in a close corporation, it appears that the result would have been the same; that it would have been the same though either was a director, and whichever was the director; that it would have been the same though one or the other owned only one-third of the stock; whereas were Salmon or Meinhard one of 400,000 stockholders, not in control of the corporation or responsible for its management, neither would have been under such a duty.

Yet, until such a case is decided, there must be some doubt as to whether this is the law of close corporations; consequently, a statute clearly creating fiduciary obligations as to the corporate property is desirable.

### *B. The Shares of the Stockholders*

In dealing with one another's shares, too, there should be, and doubtless is, a fiduciary duty.

In *Sautter v. Fulmer*<sup>48</sup> the defendant owned or controlled 307 of the 600 shares of a newspaper publishing corporation, the seven plaintiffs owning the rest. Third parties approached the defendant regarding purchase either of his or all of the shares (disputed as to which). The defendant told the plaintiffs that \$300 a share had been offered for stock of the corporation.

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<sup>44</sup>249 N. Y. 458, 164 N. E. 545 (1928).

<sup>45</sup>*Id.* at 467, 164 N. E. at 548.

<sup>46</sup>*Id.* at 465, 164 N. E. at 547.

<sup>47</sup>*Id.* at 466, 164 N. E. at 547.

<sup>48</sup>258 N. Y. 107, 179 N. E. 310 (1932).

When the defendant was asked whether this was what he was getting, he "skillfully avoided" the issue.<sup>49</sup> The court found, however, that the plaintiffs were justified in inferring that he too was getting \$300. In fact, he received \$1098 a share. The plaintiffs sought, in an accounting action, 293/600 of the total purchase price paid, and received it. The conclusions of law below, not disturbed above, were that the defendant "owning the controlling stock in said corporation, occupied a fiduciary relationship to the plaintiff and to the other minority stockholders"; "that by reason of such relationship" the defendant was under a duty to make full disclosure, which meant the exact terms of the offer, which duty the defendant did not fulfill. Counsel for the defendant (former Chief Judge Hiscock) argued that no such relationship exists between stockholders of a corporation. The plaintiff relied primarily on *Falk v. Hoffman*<sup>50</sup> and *Meinhard v. Salmon*.<sup>51</sup> The court cited these cases as authority for the judgment "against one occupying a fiduciary position." No reference being made anywhere to an agency by defendant in the sale, the only fiduciary relation traceable is that in the conclusions of law.

In *Falk v. Hoffman*, up on demurrer, the complaint alleged fraud, and was held to state a cause of action against a trustee for his wrong. *Meinhard v. Salmon* rested too on a relationship of trust.

It is difficult, therefore, to resist the conclusion that the *Sautter* case establishes that one stockholder in a close corporation may not bargain with the freedom of the market-place with respect to the stock-interests of his co-stockholder.

### C. Destruction of Stock Interests

Recognition of the fiduciary character of the relationship of stockholders in a close corporation has been given where two try to "freeze out" the third. The problem presented by "freeze-outs" is appropriately discussed below with reference to dissolution, but mention of judicial approval of the fiduciary principle should be made here.

In *Kavanaugh v. Kavanaugh Knitting Co.*,<sup>52</sup> two of the three stockholders with equal interests attempted a statutory dissolution without judicial proceedings in order to eliminate the third and to carry on the business in another entity for their own benefit. The three were sole directors. The statute then required that a majority of the board deem dissolution advisable, and if they so resolved, two-thirds of the stockholders might effect it.<sup>53</sup> The two,

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<sup>49</sup>This is the wording of the findings of the court.

<sup>50</sup>233 N. Y. 199, 135 N. E. 243 (1922).

<sup>51</sup>See note 44 *supra*.

<sup>52</sup>226 N. Y. 185, 123 N. E. 148 (1919).

<sup>53</sup>Then, under N. Y. General Corporation Law §§ 170, 171 as now under §§ 101, 102,

as directors, so resolved and, as stockholders, so voted. The Court of Appeals restrained dissolution.

Three reasons were stated: (1) the two, in voting as directors, were fiduciaries; (2) stockholders, when vested with the power to determine corporate action, are fiduciaries; (3) directors, voting as stockholders, are still fiduciaries. Since the vote resulted in unfairness, fiduciary obligations were broken.

The first reason can hardly be controverted, but, evidently, the court felt it insufficient to sustain the decision, in view of the stockholder vote. The third reason, if sound, would rarely have practical significance except in a close corporation. There, it raises the same question: Would "Meinhard," not a director, be free, as a stockholder, to vote for his personal interests, while director "Salmon," as a stockholder, would not? The second reason, if general corporate law, would certainly undermine the generality that stockholders are fiduciaries to one another only when usurping the functions of the board.<sup>54</sup> It should be noted that the majority was not a single interest, but was made up of minority interests, so that the second reason is an assertion that minority stockholders, in voting, are fiduciaries. Of course, if the second reason is law, the third reason is redundant.

The very statement of the second reason indicates that the first reason is insufficient and that the court was not content to rely on the third reason and thus allow the stockholder who pulls the strings for puppet directors to escape.

The case seems clearly peculiar to close corporations, holding "freeze-outs" forbidden because of the fiduciary character of the members of close corporations.<sup>55</sup> While dissolution is the chief case where, for workability, an exception should be made to the enforcement of fiduciary obligations,<sup>56</sup> the recognition of the principle in the *Kavanaugh* case is no less significant.

#### D. *The Books*

Strangely enough, despite the *Sautter* and *Kavanaugh* decisions, and contrary to all principles of good faith, a stockholder who wishes to inspect the corporation's books or demand a report of the president finds the authorities difficult.

The general rule for all corporations is that a stockholder has a legal right

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a majority of the stockholders could compel institution of proceedings for a judicial dissolution but, as will be pointed out, it had been held that in such cases the court must consider the interest of the minorities, or that the court must be satisfied that dissolution is to the advantage of stockholders as such and not of the majority as individuals.

<sup>54</sup>Cf. cases cited in notes 41-43 *supra*.

<sup>55</sup>The statute no longer requires the directors to resolve that dissolution is advisable. N. Y. STOCK CORPORATION LAW § 105.

<sup>56</sup>See part VIII *infra*.

to examine the corporate books, but, unfortunately, its application is left to judicial discretion.<sup>57</sup> Statutory requirements of access to the stock-book<sup>58</sup> and to the balance-sheet on application of holders of three per cent of the stock<sup>59</sup> are of no practical importance in a close corporation, and the judicial discretion beyond that has been exercised so as to require the stockholder to establish that his motives are not "ulterior." The problem arises repeatedly where one stockholder is incapacitated and, during his absence, wants to know what is happening or where one stockholder dies and his heirs want to know.

While a recent decision of the Court of Appeals,<sup>60</sup> to the effect that a desire to determine whether there has been mismanagement is a proper motive, may cause the pendulum to swing to greater liberality, it has been heretofore said that the petitioner must show he needs the inspection to protect his interests,<sup>61</sup> that the motive of ousting the management—apparently though justified—is "ulterior,"<sup>62</sup> that a stockholder individually engaged in a similar business must, because of possible misuse of the information, be denied access to the books of the corporation in which he owns twenty-five per cent of the stock.<sup>63</sup>

Under such rulings, petitioners owning, for example, fifty per cent, forty-three per cent, thirty-three and one-third per cent, and twenty-five per cent of the stock have been required to justify their motives.<sup>64</sup> Strangely, too, similar restrictions are found in French<sup>65</sup> and Belgian<sup>66</sup> laws, though authoritatively condemned.<sup>67</sup>

The French and Belgian laws may be defended, however, in that there is no limit to the number of stockholders in the former's S. A. R. L., and the limit is fifty in the corresponding Belgian corporation. In our large corporations, the application of judicial discretion may be necessary to let the book-

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<sup>57</sup>Matter of Steinway, 159 N. Y. 250, 53 N. E. 1103 (1899).

<sup>58</sup>N. Y. STOCK CORPORATION LAW § 10.

<sup>59</sup>*Id.* at § 77.

<sup>60</sup>Durr v. Paragon Trading Corp., 270 N. Y. 464, 1 N. E. (2d) 967 (1936).

<sup>61</sup>Matter of Latimer v. Herzog Teleseme Co., 75 App. Div. 522, 78 N. Y. Supp. 314 (1st Dep't 1902). That the purpose of the inspection must be "reasonable" is also the view adopted in the Uniform Business Corporation Law § 35.

<sup>62</sup>Matter of Rehe, 136 Misc. 136, 239 N. Y. Supp. 41 (Sup. Ct. 1930).

<sup>63</sup>Matter of Kennedy, 75 App. Div. 188, 77 N. Y. Supp. 714 (3d Dep't 1902).

<sup>64</sup>Matter of Hastings, 128 App. Div. 516, 112 N. Y. Supp. 800 (1st Dep't 1908), *aff'd*; 194 N. Y. 546, 87 N. E. 1120 (1909) (fifty per cent); People *ex rel* Ludwig v. Ludwig & Co., 126 App. Div. 696, 111 N. Y. Supp. 94 (1st Dep't 1908) (forty-three per cent); People *ex rel* Poletti v. Poletti *et al.*, 193 App. Div. 738, 184 N. Y. Supp. 368 (1st Dep't 1920) (thirty-three and one-third per cent); Matter of Kennedy, 75 App. Div. 188, 77 N. Y. Supp. 714 (3d Dep't 1902).

<sup>65</sup>France: Art. 30.

<sup>66</sup>Belgium: 114<sup>23</sup>

<sup>67</sup>COPPER-ROYER, *op. cit. supra* note 40, at pp. 193-197.

keepers get at their books. In the close corporation it is unwarranted. The cases seem to draw no distinction. Statutory statement, therefore, appears necessary.<sup>68</sup>

### E. Majority Agreements and Voting Trusts

Apart from the statutory right of stockholders to bind themselves to joint action through a voting trust,<sup>69</sup> they may, by agreement, bind themselves in the selection of the board.<sup>70</sup> A majority, in league, may thus eliminate the minority voice completely. The difference between such an agreement and one as to office, dividends, *etc.*, is, as far as the minority is concerned, frequently tweedledum and tweedledee,<sup>71</sup> for the agreement generally results in a division of the spoils. The technical distinction, however, is pressed to the point where a third party may not enforce an agreement as to office made by the single, majority, dominating stockholder.<sup>72</sup>

A very recent case, falling between *Clark v. Dodge* and the majority agreement cases, is *Rochester v. Bergen*, et al.<sup>73</sup> Two months after the decision in *Clark v. Dodge*, a stockholders' agreement was drawn, apparently by a layman, in which the two unequal, common stockholders, the president and treasurer of the corporation, agreed to "bind themselves to a reciprocal contract of employment" for ten years "so far as it is not in contrast with the interests and rights of the other preferred stockholders." Thereafter, the treasurer was removed from office and sought specific performance of his agreement and the payment of his salary, the salaries being payable to the parties in their capacities as officers. Neither party requested a finding that plaintiff was unfaithful, inefficient, or incompetent or that the agreement was "in contrast" with the interests of the preferred stockholders or of creditors. The lower court, assuming that the agreement for "reciprocal" employment was one to keep in office, found it unenforceable, and

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<sup>68</sup>For the affirmative duty of disclosure as between partners, see *Butler v. Prentiss*, 158 N. Y. 49, 52 N. E. 652 (1899); *Kelly v. Delaney*, 136 App. Div. 604, 121 N. Y. Supp. 241 (1st Dep't 1910), *aff'd*, 205 N. Y. 618, 98 N. E. 1105 (1912); *Wright v. Duke*, 91 Hun 409, 36 N. Y. Supp. 853 (1st Dep't 1895); *Guggenheim v. Guggenheim*, 95 Misc. 332, 159 N. Y. Supp. 333 (Sup. Ct. 1916).

<sup>69</sup>N. Y. STOCK CORPORATION LAW § 50.

<sup>70</sup>*McQuade v. Stoneham*, 263 N. Y. 323, 189 N. Y. 234 (1934); *Manson v. Curtis*, 223 N. Y. 313, 119 N. E. 559 (1918). Strictly, these cases are not holdings on the point, but they leave no doubt on the rule. These agreements apparently may be made without time limit as contrasted with voting trusts.

<sup>71</sup>See *Lehman, J.*, concurring in *McQuade v. Stoneham*, 263 N. Y. 323, 333, 189 N. E. 234, 248 (1934).

<sup>72</sup>*Fabre v. O'Donohue*, 185 App. Div. 779, 173 N. Y. Supp. 472 (2d Dep't 1918). In *Beer v. Chandler*, 289 N. Y. —, 43 N. E. (2d) 529 (1942), plaintiff recovered nothing for the loss of office contracted for, but it seems counsel did not raise this issue, their theory being that fraud induced him to take the office.

<sup>73</sup>Law Report News, March 5, 1943, 9 (App. Div. 2d Dep't 1943).

then also found that the preferred stockholders had not consented, but held the defendants (the corporation, the other directors, and the other common stockholder) were estopped to show this non-consent; therefore, he enforced the agreement. The Appellate Division, holding the agreement unenforceable preferred to "construe" the word "employment" as not referring to office and therefore found for the defendant. Since preferred stockholders are also stockholders, this was in fact a majority agreement and consequently differs from *Clark v. Dodge*.<sup>74</sup>

Thus, all the stockholders may not bind themselves, except where the case falls within the not-yet-too-clear formula of *Clark v. Dodge*, to salary agreements, but fewer than all may combine to pack the board and take all the emoluments it controls.

If the relation is fiduciary, for two or more stockholders to combine in advance to vote as a bloc, regardless of the merits of a future issue and of their opinions when it arises, is, in no sense, a fulfillment of the obligation of fair dealing with the other stockholders. Such agreements are better eliminated.

#### F. The Rule and Exceptions

The rules of the *Sautter* and *Kavanaugh* cases, applying special principles to close corporations, should be the general rule and not the exceptions, because they fit the facts of the close, trusting relationship. Whatever the point at issue, the fiduciary principle should be the starting point and exceptions should be engrafted by statute. Where the party seeking to enforce the rule is unfair, there is no exception, for equitable duties do not go so far.

### VI. RELATIONS OF THE CORPORATION TO THIRD PARTIES

For the sake of organization, the logically prior question of *ultra vires* will be discussed later. Assuming acts *intra vires*, it is evident that there are substantial factual distinctions between public and close corporations as to (1) when any officer may bind the corporation and (2) which officer may bind it in which respect.

A careful reading of the cases discloses that in this respect the courts have penetrated form and have given due regard to the co-ownership, co-directorship, co-management of the stockholders in close corporations, regardless of their titles. The welter of verbiage, however, which frequently makes no such distinction, leaves occasional necessity to litigate these questions, occasional

<sup>74</sup>An agreement by the parties for "identical" remuneration was also not enforced, whether on the theory that it fell with the agreement as to office or on the theory that the parties had originally intended only that plaintiff's compensation should not exceed that of those defendant's not appearing.

uncertainty as to when technicality will be raised successfully, and ever a vestige of doubt as to when a contract will be binding on the corporation.

#### A. The Cases

The opinions distinguish between general and other officers. "The president or other general officer has power, *prima facie*, to do any act which the directors could authorize or ratify."<sup>75</sup> The secretary appears to be a general officer on equal footing with the president.<sup>76</sup> "*Prima facie*" doubtless means that the corporation may show that actual authority is wanting.<sup>77</sup> Thereupon, the plaintiff must establish apparent authority, within the ordinary rules of agency or partnership.<sup>78</sup> The general officers have apparent authority "to act in accordance with the general usage and practice of such corporations and of the business in which the particular corporation is engaged, and their acts within the scope of an authority to be presumed from such conditions will bind the corporation in favor of persons possessing no knowledge of a lesser authority, or who are not in possession of facts sufficient to put a prudent man on inquiry."<sup>79</sup>

With one notable exception, however, it may be said that contracts *intra vires* of the close corporation have been upheld when made by any officer.<sup>80</sup> A contract, made by the secretary, assigning the rents of the corporation's property, has been held valid,<sup>81</sup> although this would be questionable, to say the least, in a public corporation. Promissory notes, made on the authority of the treasurer alone, where he was general factotum, have been enforced.<sup>82</sup> In each of these cases, the distinction between the close and public corporations was expressly noted. One exception was *Berwin v. Hewitt Realty Co.*,<sup>83</sup> where the president and treasurer of a close corporation were held

<sup>75</sup>Hastings v. B. L. Ins. Co., 138 N. Y. 473, 479, 34 N. E. 289, 291 (1893). This was quoted as law in *Harding v. Morgan Lithograph Co.*, 247 N. Y. 332, 338, 160 N. E. 388, 390 (1928), and *Tweyeffort v. Unexcelled Mfg. Co., Inc.*, 263 N. Y. 6, 9, 188 N. E. 138, 139 (1933).

<sup>76</sup>Hastings v. B. L. Ins. Co., 138 N. Y. 473, 34 N. E. 289 (1893); *Barkin Construction Co. v. Goodman*, 221 N. Y. 156, 116 N. E. 770 (1917); *Traitel Marble Co. v. Brown Brothers, Inc.*, 159 App. Div. 485, 144 N. Y. Supp. 562 (1st Dep't 1913); *Nathan v. Regent Laundry Service, Inc.*, 153 Misc. 543, 274 N. Y. Supp. 509 (N. Y. C. Ct. 1933).

<sup>77</sup>*Hardin v. Morgan Lithograph Co.*, 247 N. Y. 332, 339, 160 N. E. 388, 391 (1928).

<sup>78</sup>This is the clear purport of the cases cited in notes 75 and 76 *supra*, and is recognized in both the majority and dissenting opinions in *Wen-Kroy R. Co. v. Public Nat. B. & T. Co.*, 260 N. Y. 84, 183 N. E. 73 (1932).

<sup>79</sup>*Traitel Marble Co. v. Brown Brothers, Inc.*, 159 App. Div. 485, 486, 144 N. Y. Supp. 562, 563 (1st Dep't 1933).

<sup>80</sup>*Hall v. Herter Bros.*, 83 Hun 19, 31 N. Y. Supp. 692 (1st Dep't 1894), *on retrial*, 90 Hun 280, 35 N. Y. Supp. 769 (1st Dep't 1895), *aff'd*, 157 N. Y. 694, 51 N. E. 1091 (1898); *Nathan v. Regent Laundry Service, Inc.*, 153 Misc. 543, 274 N. Y. Supp. 509 (N. Y. C. Ct. 1933).

<sup>81</sup>*Barkin Construction Co. v. Goodman*, 221 N. Y. 156, 116 N. E. 770 (1917).

<sup>82</sup>*Haff v. L. I. Fuel Corp.*, 233 App. Div. 117, 251 N. Y. Supp. 67 (2d Dep't 1931).

<sup>83</sup>199 App. Div. 453, 191 N. Y. Supp. 817 (1st Dep't 1922), *aff'd*, 235 N. Y. 608, 139 N. E. 754 (1923) (Cardozo and Crane, JJ. dissenting).

unauthorized to engage the corporation to pay brokerage commissions because they were unauthorized to sell the land. This case, unjust on its face, has apparently been overruled.<sup>84</sup>

### B. The Suggestion

Certain acts of an officer, like certain acts of a partner, should not bind the firm. Acts such as disposing of the factory of a manufacturing firm obviously put third parties on notice of a lack of power. These acts should be enumerated in the statute, as in the Partnership Law. The partnership rule, however, which gives each partner equal power to bind the firm, in the unexcepted cases, would, at times, prove unsatisfactory in close corporations. Often, employees are given shares of stock; sometimes, they buy minor interests in the firm; frequently, shares are inherited by one or more who know nothing of the business; occasionally, shares are held in unsubstantial amounts for a variety of reasons.

When stockholders are of sufficient consequence to be officers, no justification appears for complicated distinctions among them.<sup>85</sup> Few laymen realize that a secretary is a general officer, while a treasurer and vice-president are not; most laymen regard the secretary as the least important of the three.

For the sake of clarification, therefore, rather than for the change it might make in existing law, it is suggested: (1) that no officer shall have authority to bind the corporation unless the act is "apparently for carrying on in the usual way the business of the corporation";<sup>86</sup> (2) that where the contract is of a type that such corporations normally enter, any officer of the corporation shall have the power to bind it, unless the third party knows of a lack of authorization to the officer, as in the case of partner, *gérant*, and *Gesellschaftsführer*.<sup>87</sup>

The tort liability of a corporation, limited to its assets, is consonant with present understanding and prevailing notions of fairness. Whether and when insurance should be required is not strictly within this subject.

## VII. ACQUISITION OF STOCK BY THIRD PARTIES

Their close relationship makes it imperative that stockholders be able to

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<sup>84</sup>St. John v. Fulton Market Realty Corp., 248 N. Y. 636, 162 N. E. 555 (1928).

<sup>85</sup>For a collection of cases, see 2 FLETCHER, CYCLOPEDIA OF CORPORATIONS (Perm. ed. (1931) § 581 (president); § 627 *et seq.* (vice-president); § 636 *et seq.* (secretary); § 654 *et seq.* (treasurer)).

<sup>86</sup>Heaman v. Rowell Co., 261 N. Y. 229, 185 N. E. 83 (1933); Noyes v. Irving Trust Co., 250 App. Div. 274, 294 N. Y. Supp. 2 (1st Dep't 1937), *aff'd*, 275 N. Y. 520, 11 N. E. (2d) 323 (1937). See Twyeffort v. Unexcelled Mfg. Co., Inc., 263 N. Y. 6, 188 N. E. 138 (1933); Chard v. Ryan Construction Co., 182 App. Div. 455, 169 N. Y. Supp. 622 (1st Dep't 1918).

<sup>87</sup>*Cf.* Belgium: Art. 114<sup>16</sup>; Germany: § 37.

control the identity of their fellows. In England<sup>88</sup> and Belgium,<sup>89</sup> in order to come within the definition of the private company and *Société de Personnes à Responsabilité Limitée*, the corporation must have restrictions upon transfer of its shares. With us, in a close corporation, it is the rare stockholders' agreement which provides no such restriction. Here is a problem obviously unrelated to public corporations.

While preserving the right of each stockholder to withdraw at any time, as when persons disagreeable to the stockholder acquire shares, it is also desirable that the remaining stockholders be not compelled to liquidate in order to achieve that end. Ordinarily, therefore, the stockholders' agreements include options to the remaining stockholders to buy at the price offered by the third party or at book value, and provisions for redeeming stock from attaching creditors. To avoid complicated provisions and to preserve such rights when stockholders' agreements are deficient, a uniform general method is desirable.

Under the Partnership Law, automatic dissolution no longer follows upon transfer of one partner's interest voluntarily or by a charging order,<sup>90</sup> but, with the exception of a partnership which has been given a long life by the agreement creating it, the effect is that the third party, as well as the partners, may end the partnership at will.<sup>91</sup>

With respect to transfer, French and Belgian laws offer suggestions. In France, shares in the S.A.R.L. are non-negotiable, but upon the consent of a majority of the stockholders, owning three-quarters of the shares, an outside purchaser may enter the firm.<sup>92</sup> This probably suffices to prevent most unwanted transfers. The Belgians place the same restrictions upon *inter vivos* transfers, except that such transfers may be made to certain close relatives with the same freedom as to other stockholders.<sup>93</sup> The most appealing provisions of the Belgian law are that, absent a stockholders' agreement to the contrary, if consent to the sale is refused by co-stockholders, the would-be seller may, if the refusal is arbitrary, compel the co-stockholders either to buy his shares at a price fixed by the court or liquidate the corporation.<sup>94</sup>

The Belgian method should be modified to allow the sale to be made, and to put the burden on co-stockholders to buy the shares at an agreed price, or a court-fixed price, or to liquidate. The same result is achieved thereby

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<sup>88</sup>See note 5 *supra*.

<sup>89</sup>See note 6 *supra*.

<sup>90</sup>N. Y. PARTNERSHIP LAW §§ 53, 54, 63.

<sup>91</sup>*Id.* at §§ 62, 63.

<sup>92</sup>France: Arts. 21-22.

<sup>93</sup>Belgium: Art. 114<sup>12</sup>.

<sup>94</sup>*Id.* at Art. 114<sup>13</sup>.

without delay to the selling stockholder; that delay could be used to oppress him.

There is no reason why those who choose should not still write their own "first refusal" and option contracts if they prefer. Such a statutory method, however, assures that a close corporation may remain close and that the retiring stockholder may sell his shares at a fair price.

### VIII. DISSOLUTION AND LIQUIDATION

Under existing law, probably nothing causes more unfairness in the conduct of close corporations than an inability to compel liquidation.

Where a minority stockholder is at loggerheads with the majority; where he is incapacitated; and probably most often when he dies and his widow becomes the stockholder, there follows a pattern so frequent that few lawyers have not observed it.

The widow, being one-half or one-third owner, thinks she is entitled at least to her husband's dividends, if not his salary. The survivors, carrying an extra burden, feel they should have larger salaries and often special emoluments. Expense accounts swell, salaries grow, net profits decline, dividends usually disappear. The widow sells out cheaply,<sup>95</sup> or holds her stock without return,<sup>96</sup> or she fights, in which case dissolution is attempted, with the active stockholders taking the business along to a new corporation.<sup>97</sup>

As a practical matter, the widow is faced with this: (1) if she owns less than a majority, she cannot force dissolution, for under General Corporation Law Section 102, a majority is needed, and under Stock Corporation Law Section 105, two-thirds; (2) unless salaries are exorbitantly raised, she will find difficulty convincing the court that raises are unjustified; (3) to fight the suit to remove minor padding of the accounts, which will be disputed, will not be worth the candle; (4) to sell out, she must take an inadequate price. The survivors may dissolve without judicial proceedings if they own two-thirds of the stock.<sup>98</sup> If they have a majority or control of the board, they may attempt judicial dissolution,<sup>99</sup> in which event they will be challenged to establish that dissolution is to the interest of all the stockholders, including the minority, as stockholders, and not as individuals, which view has the sanction of the cases.<sup>100</sup> A suit by the widow on the same

<sup>95</sup>*Von Au v. Magenheimer*, 126 App. Div. 257, 110 N. Y. Supp. 629 (2d Dep't 1908), *aff'd*, 196 N. Y. 510, 89 N. E. 1114 (1909).

<sup>96</sup>*Kavanaugh v. Kavanaugh Knitting Co.*, 226 N. Y. 185, 123 N. E. 148 (1919).

<sup>97</sup>*Godley v. Crandall & Godley Co.*, 212 N. Y. 121, 105 N. E. 818 (1914).

<sup>98</sup>N. Y. STOCK CORPORATION LAW § 105.

<sup>99</sup>N. Y. GENERAL CORPORATION LAW §§ 101, 102.

<sup>100</sup>*Hitch v. Hawley*, 132 N. Y. 212, 30 N. E. 401 (1892); *Matter of Rateau Sales Co.*,

ground may prevent a voluntary dissolution even though the survivors own two-thirds of the stock, under the *Kavanaugh v. Kavanaugh Knitting Co.* doctrine.<sup>101</sup> While the statute has been changed so that two-thirds of the stockholders entitled to vote may choose dissolution without any resolution by the directors that they deem it advisable, the second and third reasons<sup>102</sup> in the *Kavanaugh* case still apply and in close corporations either reason standing alone would suffice to defeat dissolution.

The European laws have made no better disposition of this problem. In France, unless so stipulated, death of one associate does not effect dissolution<sup>103</sup> and no special provision is made for dissolution of the S.A.R.L., as distinguished from the *Société Anonyme*, the public corporation. In Germany, three-quarters vote or "important grounds" are requisite to compel dissolution.<sup>104</sup> The English require three-quarters, or proof that it is "just and equitable" that there be a dissolution.<sup>105</sup> The Belgians, except for the provision next discussed, mention only serious depletion of capital<sup>106</sup> as cause for dissolution, this being a ground also in the other countries.

The Belgians meet the problem which arises most frequently, the succession by the widow or children to stock ownership. Shares are made freely alienable or descendible to husband or wife and to direct lineal ascendants and descendants.<sup>107</sup> If the other stockholders refuse to accept these alienees or inheritors as voters, the stock ceases to carry voice. In that case, the unacceptable ones may, as in the case of the stockholder who wants to sell his shares, have the court fix a fair price, and if the others will not pay it, they may compel dissolution.<sup>108</sup>

In many cases this gives a satisfactory result, but where the widow and children are accepted fully and are then voted down effectively, it is no solution.

In this type of case, there is today rarely an honorable and agreeable solution. If either the widow or the survivor, however, may compel dissolution, all the assets, including good will,<sup>109</sup> may be sold, the widow has her just share, and the survivors may support themselves freely in a new business, freed of her. The fiduciary obligations recognized in the *Kavanaugh*

201 N. Y. 420, 94 N. Y. 869 (1911); Matter of American Tel. & Cable Co., 139 Misc. 625, 248 N. Y. Supp. 98 (1931).

<sup>101</sup>*Kavanaugh v. Kavanaugh Knitting Co.*, 226 N. Y. 185, 123 N. E. 148 (1919).

<sup>102</sup>See part V, section C, *supra*.

<sup>103</sup>France: Art. 36.

<sup>104</sup>Germany: §§ 60, 61.

<sup>105</sup>England: Companies Act, 1929, 19 & 20 Geo. 5, c. 23 § 168.

<sup>106</sup>Belgium: Art. 114<sup>26</sup>.

<sup>107</sup>*Id.* at Art. 114<sup>12</sup>.

<sup>108</sup>*Id.* at Art. 114<sup>14</sup>.

<sup>109</sup>*Cf.* *Godley v. Crandall & Godley Co.*, 212 N. Y. 121, 105 N. E. 818 (1914).

case are sound, but the need for freedom of dissolution overrides those duties in this instance. Such is the rule in partnership, except that the majority there may take along the partnership name.<sup>110</sup>

Dissolution, of course, may be used as an instrument of injustice.<sup>111</sup> A minority stockholder who has risked his capital and devoted his energy to building a business, may, if excluded by dissolution, be unable to compete with the majority, who start anew. But, in close corporations, lack of harmony may well be a greater obstacle to success, and, in addition, the greater frequency of injustice resulting from inability to dissolve justifies the exception.

Accordingly, it is suggested that freedom of dissolution, as in partnerships, be conferred. The corporation or the majority stockholders, may by paying a fair price, continue, just as partners who so desire may remain together. The party who is squeezed may retire at a fair price. If, unfortunately, the money to buy out is not available, it is still better to liquidate, give a share of the assets to each, and avoid disagreeable continuance with no return to the weak.

If provision is made in accordance with these suggestions, the question arises whether, as against co-contractors, the dissolution is voluntary. As in partnership,<sup>112</sup> no contract of the parties or with third parties should prevent dissolution. But voluntary dissolution justifies liability for termination of performance.<sup>113</sup> The dissolution forced by one of the stockholders should be treated as voluntary, creating liability to the other party to the contract.

#### IX. MANNER OF INCORPORATION AND POWERS

Certain considerations as to form are also relevant.

First, there is no reason why one man or a corporation should not form a close corporation. The hocus-pocus of three subscribers, three directors and officers for a one-man corporation should be forgotten; let the one man form his corporation and be its officer. A corporation, after the drivel of having some dummies incorporating a subsidiary, which it cannot itself do,<sup>114</sup> may acquire all the stock.<sup>115</sup> This circumlocution should be put in limbo.

Secondly, since organization of close corporations precedes filing the cer-

<sup>110</sup>N. Y. PARTNERSHIP LAW § 80(2).

<sup>111</sup>Cf. Hornstein, *Voluntary Dissolution—A New Development in Intracorporate Abuse* (1941) 51 YALE L. J. 64.

<sup>112</sup>N. Y. PARTNERSHIP LAW § 62(2). *Cahill v. Haff*, 248 N. Y. 377, 162 N. E. 288 (1928); *Burnstine v. Geist*, 257 App. Div. 792, 15 N. Y. S. (2d) 48 (1st Dep't 1939).

<sup>113</sup>*People v. Globe Mutual L. I. Co.*, 91 N. Y. 174 (1883); *Mason v. Standard Distilling, etc., Co.*, 85 App. Div. 520, 87 N. Y. Supp. 343 (1st Dep't 1903).

<sup>114</sup>N. Y. STOCK CORPORATION LAW § 5. *Schwab v. Potter & Co.*, 194 N. Y. 409, 83 N. E. 670 (1909).

<sup>115</sup>N. Y. STOCK CORPORATION LAW § 18.

tificate, the certificate may well contain information for the benefit of those who read it, be signed by the true stockholders, and list the names of its actual officers and directors. For all practical purposes, the corporation exists when its certificate is mailed.<sup>116</sup> This bit of realism might make the certificate of some assistance.

Thirdly, it may well be questioned, whether apart from measuring the tax on the corporation, a clause setting forth the classification of shares and the authorized capital is of any value. The actual capital, as in limited partnerships, if any capital is to be stated, would serve a better end.

Fourthly, the tedious labor and the reams of paper that go into "purposes" stated in the certificate of incorporation should be saved. If a corporation exceeds its powers today, it is generally through illegality or because of very poor draftsmanship, because acts *ultra vires* must exceed not only express powers, but all the "incidental" ones which are generously implied,<sup>117</sup> the certificate, of course, is freely amendable. If creditors are theoretically injured by the corporation's exceeding its powers, it is only because the draftsman forgot the extra words that would have made the act *intra vires*. If stockholders are to be protected, a more effective method is to direct their attention to drawing limitations on general powers rather than to passing on an exhausting list of purposes. The certificate should confer the power to do all things that an individual or partnership might do,<sup>118</sup> subject only to expressed restrictions.

Whether the best way to accomplish this technically is by an elaborate section or by a simple removal of the necessity to state powers, or by an in-between method, need not be discussed here. Precedents exist in other states.<sup>119</sup>

Such blanket authority would eliminate restraints imposed by corporate theory, such as that a corporation may not enter a partnership,<sup>120</sup> even though

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<sup>116</sup>Of course, it may be returned if the purchaser proposes an illegal business, *Matter of Stewart v. Dep't of State*, 174 Misc. 902, 22 N. Y. S. (2d) 164 (Sup. Ct. 1940), *aff'd*, 260 App. Div. 979, 23 N. Y. S. (2d) 226 (3d Dep't 1940), but intent is not normally revealed in the certificate. Mechanical errors, too, occur but they may be quickly remedied.

<sup>117</sup>*Cf.* 7 FLETCHER, CYCLOPEDIA OF CORPORATIONS (Perm. ed. 1931) 561. See *Curtis v. Leavitt*, 15 N. Y. 9, 64 (1857); *Holmes v. Willard*, 125 N. Y. 75, 25 N. E. 1083 (1890); *Koehler v. Reinheimer*, 26 App. Div. 1, 49 N. Y. Supp. 755 (1st Dep't 1898).

<sup>118</sup>In *Holm v. Claus Lipsius Brewing Co.* 21 App. Div. 204, 207, 47 N. Y. Supp. 518, 520 (2d Dep't 1897), Goodrich, P.J., said "The doctrine of *ultra vires* originated at a time when nearly all corporations were created for public purposes; and there is no reason why it should ever have applied to private corporations any more than to the powers of individuals in a partnership."

<sup>119</sup>See Stevens, *Ultra Vires Transactions under the New Ohio General Corporation Act* (1930) 4 U. OF CIN. L. REV. 419 and the references and statutes quoted there.

<sup>120</sup>*People v. North River Sugar Refining Co.*, 121 N. Y. 582, 24 N. E. 834 (1890).

the certificate of incorporation expressly includes that power.<sup>121</sup> It would eliminate the law that certain powers exist only if embodied in the certificate, such as the right to purchase stock in another corporation.<sup>122</sup> Entering a partnership, for example, has saved many corporations without threatening any readily foreseeable harm.<sup>123</sup>

#### X. PROVISIONS OF OTHER LAWS

Many requirements of the General and Stock Corporation Laws should be fully applicable to a close corporation. Such sections as 15, 58, and 59 of the Stock Corporation Law should be incorporated by reference, as should Section 35 with modifications. Other sections, such as 85 *et seq.*, seem both unnecessary and undesirable.

Taxation, with us, has always been a matter apart from corporation laws. Factors other than legal theory and business practice enter. Whether close corporations should, for tax purposes, be treated as a partnership or as a corporation will not be considered.

#### CONCLUSION

Because of the broad scope covered here, it has been impossible to give adequate examples of each of the situations, so familiar to practitioners, which need remedying. In many respects, the law of today is unsuitable; in others, there is grave doubt as to what the law is. Some modification and clarification are needed; the annexed draft of a statute is the writer's conception of the type desired. Where suitable the wording of the Stock Corporation and Partnership Laws has been used. Section 21 has been copied, in part, from the Ohio General Corporation Act. The other sections are original.

#### APPENDIX

##### THE CLOSE CORPORATION LAW

###### ARTICLE I

###### *Short Title; Application*

**Section 1. Short Title.** This chapter shall be known as the Close Corporation Law.

**Section 2. Application.** This chapter shall apply to any stock corporation in which

<sup>121</sup>In (1935) *Opinions of the Attorney-General* 230, the conclusion was reached that a provision in the certificate permitting the corporation to enter a partnership, should be stricken; and that the inclusion of a corporation as a "person" in the N. Y. Partnership Law § 2 was an oversight. In other states, it has been held that including such power in the certification empowered the corporation to enter a partnership. See 3 COOK, LAW OF CORPORATIONS (8th ed. 1923) § 678.

<sup>122</sup>N. Y. STOCK CORPORATION LAW § 18.

<sup>123</sup>See *Schneider v. Greater M. & S. Circuit, Inc.*, 144 Misc. 534, 259 N. Y. Supp. 319 (Sup. Ct. 1932).

the stock is owned by not more than five persons who elect to incorporate under this law. The representatives of a decedent's estate shall for one year after his decease be deemed one person within the meaning hereof. Otherwise, whether the stockholder is a corporation, partnership, trustee, executor, administrator, nominee or any other representative, the number of persons beneficially interested as stockholders, partners, beneficiaries, legatees, principals, *etc.*, shall be deemed the number of stockholders.

**Section 3. Supervening Disqualification.** Whenever the ownership of the stock ceases to be held by as few as five persons, upon petition of the Attorney-General or of any stockholder, the Supreme Court shall order a vote of the stockholders within a reasonable time to elect: (1) to qualify under the Stock Corporation Law, in which event any stockholder shall have the right to the relief provided under Section 70 hereof, or, (2) to dissolve and liquidate, or, (3) to requalify if by voluntary purchase and sale of shares by one stockholder to another, the number of stockholders is reduced to five or fewer.

**Section 4. Supervening Qualification.** Any corporation now or hereafter organized which is or becomes qualified for incorporation hereunder may by unanimous vote of its voting stock elect to become a "close" corporation by filing a certificate under Section 20 hereof. With respect to any action taken prior thereto, the law theretofore governing shall continue to do so.

**Section 5. Limitations.** Nothing herein contained shall abridge the right of any "close" corporation or any corporation which would be able to qualify as a "close" corporation to qualify under the Stock Corporation Law rather than hereunder. No close corporation shall engage in any business forbidden under the Stock Corporation Law.

#### ARTICLE 2

##### *Organizing a Close Corporation*

**Section 10. Organization Meeting.** Any qualified person may organize a close corporation by subscribing and filing a certificate of incorporation in accordance with Section 20 hereof. When a close corporation is to be formed by more than one person, they shall meet and elect one or more officers or directors, who shall serve for one year after the incorporation. Thereafter, the actual owners of the initial capital shall subscribe and file a certificate of incorporation in accordance with Section 20 hereof. Upon the filing thereof, the corporation, its officers and directors shall be such in law.

#### ARTICLE 3

##### *Formation of Close Corporations*

**Section 20. Incorporation.** Any person, any number of persons, any corporation, or any aggregate of persons may form a close corporation for any lawful business purpose or purposes permitted under the Stock Corporation Law by making, subscribing, acknowledging, and filing a certificate which shall be entitled and endorsed "Certificate of Incorporation of ..... pursuant to Article Three of the Close Corporation Law" (the blank space being filled in with the name of the corporation) and which shall state:

1. The name of the proposed corporation.
2. What business and other powers, if any, in addition to those prohibited by

law or prohibited without compliance with certain conditions, the corporation shall not be permitted to do or exercise.

3. The amount of cash and a description of and the agreed value of the other property, forming the initial capital of the corporation.

4. Either the amount of the capital stock and the number and par value of the shares of which it is to consist, or, if the corporation is to issue shares without par value, the statements required by Section 12 of the Stock Corporation Law.

5. If the shares are to be classified, the number of shares to be included in each class and all of the designations, preferences, privileges, and voting powers of the shares of each class, and the restrictions or qualifications thereof.

If any class of stock which is preferred as to dividends or assets is to be issued in series as provided by Section 11 of the Stock Corporation Law, either (a) the designations, preferences, privileges, and voting powers of the shares of the first series of such class, and the restrictions or qualifications thereof, and that the board of directors is authorized to fix from time to time before issuance the designations, preferences, privileges, and voting powers of the shares of each subsequent series of such class, and the restrictions or qualifications thereof, or (b) that the board of directors is authorized to fix from time to time before issuance the designations, preferences, privileges, and voting powers of the shares of each series of such class, and the restrictions or qualifications thereof.

6. The city, village, or town, and the county, within the state, in which the office of the corporation is to be located, and the address, within or without the state, to which the Secretary of State shall mail a copy of process in any action or proceeding against the corporation which may be served upon him.

7. Its duration.

8. The names and addresses of (1) the legal and beneficial owners of its stock; (2) its director or directors; (3) its officer or officers. There may be one or more stockholders, directors, or officers.

9. That all the subscribers of the certificate are of full age, that at least two-thirds of them are citizens of the United States, and that at least one of them is a resident of the State of New York.

10. If meetings of the board of directors are to be held only within the state the certificate must so provide.

11. The certificate shall be subscribed by all the stockholders.

The certificate may contain any additional agreements of the stockholders which may govern their relations among themselves.

**Section 21. Powers of a Close Corporation.** Whenever a corporation shall be formed under this law, it shall have the capacity and all the powers of an individual with respect to all lawful business permitted under the Stock Corporation Law, except insofar as such powers are prohibited or limited in Paragraph 2 of its certificate of incorporation and any certificate amendatory thereto.

No limitation on the exercise of the authority of the corporation shall be asserted in any action between the corporation and any person, except by or on behalf of the corporation against a director or an officer or a person having actual knowledge of such limitation.

## ARTICLE 4

*Stock, Stockholders, Officers, and Directors*

**Section 30. Stock.** The interests of stockholders in a close corporation shall be represented by shares of stock, which shall be non-assessable. Stock shall be issued only for money, labor done, or property actually received for the use and lawful purposes of such corporation. Every statement filed or issued for any purpose of the corporation showing stock ownership or the financial condition of the corporation shall state the number and class of shares issued for property and the number and class of shares issued for services. No stock shall be issued for services rendered or property received unless the director or directors honestly believe the fraction of the corporation's net worth represented by the shares issued is no greater than the value of the labor done or property received. The issuance of a greater number of shares for labor or property than so prescribed without such honest belief shall constitute a fraud on stockholders opposing or not participating and the failure to reflect such labor done or property received on the books or any statements of the corporation shall constitute a fraud on all creditors becoming such subsequent to the sale of stock.

**Section 31. Preferred and Common Shares.** A close corporation shall have power to create and issue two or more classes of shares, with such designations, preferences, privileges, and voting powers or restrictions or qualifications thereof as the certificate of incorporation, or other certificate creating such shares and filed pursuant to law, provides; but no shares which are entitled to preference in the distribution of dividends or assets shall be designated as common stock or shares.

**Section 32. Shares Without Par Value.** A close corporation may issue shares without par value under the terms and conditions set forth in Section 12 of the Stock Corporation Law.

**Section 33. Form of Certificate.** The form of the certificate of stock shall be that prescribed in the Stock Corporation Law, except that it need be signed by only one officer if there is only one, and by any two officers if there are more than one.

**Section 34. Increase of Stock.** Unless provided for in an agreement made by all stockholders, there shall be no increase in the number of issued shares, whether such increase is by way of increasing authorized capital or of increased issuance within previously authorized capital; and unless provided to the contrary in an agreement made by all stockholders, Section 39 of the Stock Corporation Law shall apply to any new issuance of stock.

Whenever stock in the corporation is sold by one or more stockholders to one or more other stockholders, their appointees or members of their families, each other stockholder shall be entitled to purchase his *pro rata* share thereof at the price paid therefore.

**Section 35. Meetings of Stockholders.** All powers not delegated by this chapter or by agreement of all the stockholders, shall reside in the stockholders and shall be exercised by them in meetings. Meetings of stockholders may be summoned by the president, the directors, or the owner or owners of ten per cent of the voting stock of the corporation in the manner provided in the Stock Corporation Law. In the absence of other agreement the provisions of the Stock Corporation Law shall govern the conduct of such meetings and the voting powers of the stockholders. By agreement of all the stockholders, the voting rights of any stockholder or the owner of any specified shares of stock may be restricted or enlarged

in any way and with respect to any matter, as specifically set forth in this article or otherwise, any provision of this or any other corporation law of this state to the contrary notwithstanding.

**Section 36. Directors.** If all the stockholders so agree, the affairs of the corporation shall be managed by a director or a board of directors. In the absence of such agreement or in the event the stockholders fail to name a director or directors, the sole supervisors of corporate affairs shall be the stockholders. In the event there is such an agreement, a director or directors named in the certificate of incorporation shall manage the affairs of the corporation until a new director or directors are named. The certificate of incorporation or any other agreement made at any time by and among all the stockholders may fix the number of directors, the method of electing the director or board of directors, and the method of removal of one or more of them. Such certificate or other agreement may grant to any stockholder or stockholders or to the present or future holder or holders of any particular shares of stock the right to designate one or more directors at some or all future elections of directors. In the absence of provision in the certificate or in such agreement as to how new directors are to be elected, the provisions of the Stock Corporation Law shall govern. Unless otherwise provided in such an agreement or certificate, a director need not be a stockholder.

**Section 37. Meetings of Directors.** In addition to any other provision made by the stockholders, directors, or corporation with respect to meetings of the board, any director may call a meeting of the board upon the giving of reasonable notice thereof (five days shall be deemed always reasonable) for the purpose of any action or countermanding any action of the corporation. The certificate of incorporation or any other agreement made at any time by and among all the stockholders may provide that action of the board may be taken only by unanimous vote or in any other way.

Unless contrary to the provisions of the certificate or such agreement, the provisions of the Stock Corporation Law shall govern the powers of directors and the manner of exercising such powers.

**Section 38. Action of the Corporation.** The certificate of incorporation or any other agreement among the stockholders may give to any particular stockholder or holder or holders of certain shares of stock, without regard to relative ownership, the right to dictate or veto any specified action or type of action on the part of the corporation, whether or not opposed by the other stockholders or the directors.

**Section 39. Decision by Third Party or Agent.** The certificate of incorporation or any agreement of the stockholders may provide that in the event of a deadlock between stockholders or directors any issues as to action by the corporation shall be left to the decision of a third party or third parties, who may but need not be stockholders, officers, or directors of the corporation. Any specific action by the corporation or the general management of the business of the corporation may by agreement of all the stockholders be entrusted to an agent or agents who need not be stockholders, officers, or directors of the corporation and the action of such third parties or agents shall be binding upon all stockholders of the corporation and the corporation in accordance with the terms of the agreement, but no such agreement shall affect the rights of third parties as set forth in Article 6 hereof.

**Section 40. Officers.** There shall be one or more executive officers of the cor-

poration. Only those denominated president, vice-president, secretary, and treasurer, and no assistant to any such officer, nor any other, shall be an officer of a close corporation. The officer or officers named in the certificate of incorporation shall act as such until removed or replaced. The certificate of incorporation or any other agreement made at any time by and among all the stockholders may: (1) fix the number of officers, the method of selecting and removing them, their duties, powers, privileges, and compensation, and (2) grant to any stockholder or stockholders or the present or future holder or holders of any particular shares of stock the right to designate one or more officers at some future time or at all times. In the absence of such provision in the certificate or agreement, the stockholders, if there are no directors, and the director or board of directors, if there are such, shall appoint and remove the officer or officers and shall fix their powers, privileges, and compensation. Unless forbidden in the certificate of incorporation or by agreement of all stockholders, the stockholders or the director or the board of directors, if there are such, may designate officers in addition to those specified in such certificate or agreement with the same power as if there were no such agreement, provided, however, that they shall not thereby infringe upon rights conferred in any such agreement. No officer of the corporation need be a stockholder or director.

**Section 41. On Whom Agreements Binding.** Any agreement sanctioned in this article and embodied in the certificate of incorporation shall be binding upon all existing and future stockholders. Any agreement referred to in this article and not embodied in the certificate of incorporation shall bind all existing stockholders and all who purchase certificates in which reference is made to the existence of such an agreement.

**Section 42. Agreements by Fewer Than All Stockholders.** No agreement by fewer than all the stockholders of a close corporation with respect to any of the types of agreement mentioned in this article shall be binding on such stockholders, the corporation, or any other stockholder.

**Section 43. Enforcement of Agreements.** Any stockholder or stockholders or the corporation may petition the Supreme Court for an order enforcing the terms of any agreement valid under this article as provided in Section — of the Civil Practice Act. Any party aggrieved by breach of such agreement may maintain an action for damages against those parties thereto who refuse to carry out its terms, or against the corporation for breach of any agreement other than one to elect the plaintiff or another a director and whenever an action lies against both the parties and the corporation, he may sue either or both.

#### ARTICLE 5

##### *Fiduciary Relationship among Stockholders*

**Section 50. Stockholders Accountable as Fiduciaries.** Every stockholder must account to the corporation for any benefit and hold as trustee for it any profits derived by him without the consent of other stockholders from any transaction in connection with the formation, conduct, or liquidation of the corporation, or from any use by him of its property, or from any transaction in which the opportunity to participate should, in equity, be given to the corporation. Every stockholder must account to the corporation for any damage he has caused the corporation

by acting in excess of his authority, in breach of any agreement with stockholders or the corporation, or in bad faith. Every stockholder must account to any other stockholder to whom as stockholder he has caused damage through inequity, which damage has not been suffered by the corporation.

**Section 51. Corporate Books.** The books of a close corporation shall include at least a stock book, a minute book, and books of account. These and any and all other corporate books shall be kept, subject to unanimous agreement of the stockholders to the contrary, at the principal place of business of the corporation. Every stockholder shall have, in person or by any representative he chooses, at all times during the corporate existence and after dissolution, access to and may inspect and copy any and all of such books in whole or in part. If any officer or agent of any such corporation shall wilfully neglect or refuse to exhibit any such book, or to allow any such book to be inspected and extracts taken therefrom as provided in this section, the corporation and such officer or agent shall each forfeit and pay to the party injured a penalty of fifty dollars for every such neglect or refusal, and all damages resulting to him therefrom. The rights of the stockholder herein provided shall be enforceable by motion in any action pending in the Supreme Court or by special proceeding in the Supreme Court.

**Section 52. Rendering Account.** The president of the corporation shall render or cause to be rendered on demand true and full information of all things affecting the corporation to any stockholder or the legal representative of any deceased stockholder or of any stockholder under legal disability.

#### ARTICLE 6

##### *Rights of Third Parties*

**Section 60. Acts of an Officer.** 1. Every officer is an agent of the corporation for the purpose of its business and the act of every officer, including the execution in the corporate name of any instrument, for carrying on in the usual way the business of the corporation of which he is an officer, binds the corporation, unless the officer so acting has in fact no authority to act for the corporation in the particular matter, and the person with whom he is dealing has knowledge of the fact that he has no such authority.

2. An act of an officer which is not apparently for the carrying on of the business of the corporation in the usual way does not bind the corporation unless authorized by the stockholders or the board of directors, if any.

3. Unless authorized by the stockholders or the board of directors, if any, no officer or officers shall have authority to:

(a) Assign the corporate property in trust for creditors or on the assignee's promise to pay the debts of the corporation.

(b) Dispose of the good will of the business.

(c) Do any other act which would make it impossible to carry on the ordinary business of the corporation.

(d) Confess a judgment.

4. No act of an officer in contravention of a restriction on his authority shall bind the corporation to persons having knowledge of the restriction.

**Section 61. Conveyance or Mortgage of Real Property.** The conveyance or mortgage of real property of the corporation shall be governed by Section 16 of the Stock Corporation Law.

**Section 62. Acquisition of Stock by Third Parties.** At any time after ownership of any shares of the stock of the corporation passes to one other than an original stockholder, whether by foreclosure of a pledge, by inheritance, by sale under execution or other legal process, by voluntary sale or otherwise, but not later than ninety days after the certificate or certificates are presented to the corporation for transfer, the corporation or, upon its refusal, the owners of more than fifty per cent of the remaining voting shares of the corporation, regardless of classification of stock, may institute proceedings pursuant to Section 21 of the Stock Corporation Law, and upon a determination under such law of the value of the stock, the corporation or the petitioning stockholders shall have the legal right within thirty days of the entry of such order, to purchase the said stock at such appraised value. The person acquiring the stock shall have no rights by virtue of such acquisition until the expiration of one or more such periods without action by the corporation or the said stockholders.

**Section 63. Tort Liability.** The liability of stockholders, officers, directors, and corporations in tort shall be the same as in the case of corporations organized under the Stock Corporation Law.

#### ARTICLE 7

##### *Dissolution of a Close Corporation*

**Section 70. Right of a Stockholder to Compel Dissolution.** Any stockholder shall have the right, upon demand, to have the corporation dissolved and liquidated, unless (1) the corporation or (2) the other stockholders or (3) the holders of a majority of the other voting shares, with right of precedence in that order, give notice within fifteen days of receipt of his demand, that they will, in thirty days, deposit in escrow a sum ten per cent in excess of the book value of his stock, pending an appraisal of his shares, and agree that upon such appraisal they will pay him the appraised value of his stock. Upon such demand being made, the corporation, the purchasing stockholders, or the selling stockholders may pursue the procedure provided in Section 21 of the Stock Corporation Law, or any procedure agreed upon by all the stockholders to obtain such appraisal, and a transfer at the appraised price shall be enforceable by order of the Supreme Court in a special proceeding for that purpose.

**Section 71. Method of Compelling Dissolution.** In the event that neither the corporation nor the stockholders specified in Section 70 shall give the notice or make the deposit within the time therein provided, and if within that time a certificate shall not be filed pursuant to Section 105 of the Stock Corporation Law, the demanding stockholder may institute a special proceeding in the Supreme Court for a dissolution of the corporation and upon a showing of the facts required in this and the preceding section, an order of dissolution and liquidation shall be made, provided that the court may make such provision for additional time for the purchase of the stock as may be just.

**Section 72. Contracts for a Period Beyond Dissolution.** The provisions of Section 70 shall apply regardless of any contracts of the corporation for a period extending beyond the period fixed for dissolution. Any party to such a contract with the corporation shall be entitled to his damages as if for breach of contract, but shall not be allowed to interfere with the dissolution.

**Section 73. Liquidation.** Upon the dissolution of a close corporation for any cause and whether voluntary or involuntary, the provisions of Section 29 of the General Corporation Law shall apply, except that by agreement theretofore or thereafter made by all the stockholders, filed and recorded in the corporate books, any person may be appointed as liquidating director, and the provisions of Section 29 of the General Corporation Law with respect to the board of directors shall apply to such director, and except that upon the termination of such director's relationship for any cause during said liquidation, any stockholder may call the meeting provided for in the said section.

**Section 74. Additional Provisions.** Unless inconsistent with the terms of this article, all provisions of the Stock Corporation Law and General Corporation Law with respect to dissolution and liquidation shall be deemed additional hereto and in nowise replaced hereby.