

GEORGIA'S URGENT NEED FOR A MODERN CORPORATION STATUTE

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This article discusses Georgia's need, as I see it, for a completely new corporation statute. Indeed Georgia needs two new statutes, one dealing with business corporations and one dealing with non-profit corporations. However, this article is directed toward a new business corporation statute.

I am mindful, of course, of the danger of an outsider's coming into a state and suggesting legislative changes. The outsider may never have had an opportunity to see existing laws in operation; he may not adequately understand local needs and problems; and he may overlook many of a new proposal's ramifications in the local setting.

Actually I do not consider myself an outsider in Georgia, having lived here eight years and having returned at every invitation or other opportunity. Nevertheless, I do not come to you with a corporation statute that I recommend for adoption. I am simply going to survey the legislative changes made in other states since your statute was enacted, point out gaps and defects in your present legislation, and call your attention to a number of specific statutory sections adopted in recent years in one or more states, including a number of novel, even controversial provisions. In short, I'm going to bring to you in capsule form information on recent statutory developments and new thinking in corporation legislation that I have assembled over the last few years in bringing out supplements to my corporation books.

Since World War II over half the states have extensively revised and updated their corporation laws. Additional states, including the popular incorporating state of Delaware, are now in the process of overhauling their laws. Draftsmen of a statute for Georgia will need to study these new statutes. Much is to be learned from them. Many

policy decisions will be involved in choosing statutory sections from them. The best talent in the Corporation Bar of Georgia should become involved in making those decisions.

Seventeen states have adopted with minor variations the Model Corporation Act of the American Bar Association's Committee on Corporate Laws, and other states have used substantial parts of it. The Model Act has been called an "enabling act," because it enables organizers of an enterprise to set up a corporation easily and to operate it without burdensome restrictions. The promoters or "insiders" are free to set up the kind of corporate organization they want. They may give management broad powers and shield them from most liabilities. Whatever the corporate promoters and planners want is, within reason, theirs for the asking. The Model Act does not focus on the protection of minority shareholders or crusade to solve alleged corporate abuses.

As I shall point out later, the present Georgia statute does not contain desirable "enabling" features. You could use an "enabling" act to advantage.

A few recent corporation statutes are considerably more restrictive than the Model Act, containing provisions designed to protect creditors and minority shareholders. Furthermore, some statutes contain provisions focusing on the needs and problems of close corporations.

A pioneering statute was the North Carolina Business Corporation Act,¹ enacted in 1955. That act was drafted by a committee of teachers and lawyers chaired by Elvin R. Latty, then Dean of the Duke Law School, now Perkin's Professor of Law at Duke. That act contained extensive and imaginative innovations to meet the needs of close corporations. More about that later. The South Carolina statute² in general follows the North Carolina statute but contains at least one unique provision. The innovations in North Carolina and South Carolina statutes should be carefully considered by the draftsmen of a Georgia act.

Another recent statute that deserves special attention is the new New York Business Corporation Law.³ It is a masterpiece of clarity, precision, and symmetry. Obviously time was given without stint to redrafting, reworking, repolishing.

A camel, some wag has observed, is a horse conceived and put together by a committee. But Dean Elvin R. Latty has observed

1. N.C. GEN. STAT. §§ 55-1 through -175 (1955).

2. S.C. CODE OF LAWS tit. 12, chs. 1.1-1.21 (Cum. Supp. 1965).

3. N.Y. BUS. CORP. LAW.

that should this wag take a look at the New York statute, his misgivings about committees might vanish.⁴ The New York statute proves that impressive results can be achieved by highly organized and skilled teams of specialists with plenty of money to spend.

Despite the work that went into the New York statute, it is still largely an enabling act. It shows only mild reformist concern with preventing or curing abuses.

Now for the defects in the present Georgia legislation. First and perhaps foremost, Georgia's present incorporation procedure is time-consuming and expensive when compared with procedures in other states, and is without compensating benefits.⁵ The procedure involves going to the Secretary of State's office for a name clearance and then filing a petition for a charter with the Superior Court. After the charter is approved by the judge and filed with the clerk, it is then filed with the Secretary of State. Furthermore, there must be publication of the terms of the charter for four weeks in an appropriate newspaper.⁶

This constitutes a marked variance from the incorporation procedure in other states. In the other states, the corporation act typically designates a state official, usually the Secretary of State, from whom a corporate charter may be obtained. The lawyer simply drafts the proposed charter, has it signed by persons acting as incorporators, and delivers it to a person in the office of the Secretary of State for certification that the charter — or "articles of incorporation" — is thereby issued by the state. The Secretary of State approves the proposed charter if it seems to be in order, if fees and taxes have been paid, and if the corporate name has been properly cleared.

Rather than give public notice of the terms of the charter by publication in newspapers, as is required by the Georgia procedure, other means to protect the public are provided, such as requiring that unambiguous words in the corporate name reveal corporate status. Increasingly, other states have found that a second filing of the charter "locally," i.e., in the county where the corporation has its principal office, serves no useful purpose and they have dispensed with it.

4. Latty, *Some General Observations on the New Business Corporation Law of New York*, 11 BUFFALO L. REV. 591 (1962).

5. This and the following paragraph of the text are based on material in Cohn and Leavell, *Georgia's Corporation Law: Is It Adequate?* 2 GA. S.B.J. 153, 157 (1965).

6. GA. CODE ANN. § 22-1802 through 1806, 1809 (1966).

What reason can there be for requiring a superior court judge to examine a proposed charter and approve it? I am not sufficiently familiar with the practice in this state to know whether judges' examinations of proposed charters are perfunctory, done purely by way of routine, or whether the judges study charters carefully, sometimes rejecting them or requiring modifications. But, in any event, it seems clear to me that Georgia courts could well be relieved of this burden. The office of the Secretary of State or a Corporations Commissioner can certainly be staffed with skilled, law-trained personnel qualified to screen proposed charters for validity. In some states, the office of the Secretary of State files charters almost as a matter of course. In an increasing number of states, the Secretary of State or a Corporations Commissioner exercises a real supervision over the content of charters. Whichever type of administration is desired can certainly be provided without adding to the duties of the courts. Furthermore, entrusting this job to the Secretary of State or a Corporations Commissioner assures uniform administration and the application of uniform standards throughout the state. If the Secretary of State or a Corporations Commissioner refuses to file a proposed charter, the lawyer can then go to court, if he wishes, to force the official to accept the charter.

Similarly, what purpose is served by requiring publication of a corporate charter four times in a newspaper? The protection of creditors? Creditors are hardly likely to remember the provisions published in a newspaper, if indeed they notice them. Creditors have other ways of protecting themselves by checking on the credit ratings of prospective debtors. If a prospective creditor of a corporation wants a copy of the corporation's charter, he can always insist that the corporation's representatives provide him with a certified copy. One of the disadvantages of requiring publication is that the lawyer drafting a charter will omit needed provisions in order to decrease publication expenses.

When I was living in Georgia I used to hear it said that the newspapers of the state, in order to protect revenue derived from publishing corporate charters, would fight any attempt to abolish the publication requirement, that it was therefore politically impossible to eliminate that requirement. I cannot believe that Georgia newspapers will insist on this kind of featherbedding; publication of such material serves no useful purpose. It seems to me that the newspapers cannot possibly make out a persuasive case for publication of corporate charters.

Another defect in the Georgia statute is that a corporation cannot be given perpetual existence in Georgia, a restriction that I should think encourages incorporation out of state. A business corporation cannot be organized in Georgia to exist for a period exceeding thirty-five years. In post-Revolution America, when corporations were distrusted and feared, limitations on the duration of corporations were common. It was also customary in the early days of this country for legislatures to place severe restrictions on the powers of corporations and on the scope of their operations. Most states have now dispensed with all of these restrictions. Only two or three states still retain the anachronistic limitation on the duration of corporate existence.

Of course a Georgia corporation can be rechartered after its term expires, but that involves unnecessary trouble and expense. I am reminded of what happened to the Georgia Bar Association some years ago. One day it occurred to officers of the Association that its charter had expired several years before and that no one had thought to renew it. Red-faced, they proceeded very quietly to renew the charter, not wanting the general public to become aware of their legal oversight.

The Georgia statutes contain many ambiguous provisions on corporations. Some of the ambiguities result from lack of definition. For example, the term "capital" is not defined. Incidentally, draftsmen of the new Georgia legislation might well benefit from consultation with accountants,⁷ especially on financial provisions in the new legislation.

The term "officers and stockholders" is used in a number of provisions without definition. Does this term also include "directors"? Similarly, does the statutory section prohibiting any "officer or agent" of a corporation from borrowing from it without permission of the board⁸ refer only to officers or agents in a technical sense or does it include also directors who, in one sense, are also agents of the corporation? These and other ambiguities provide unnecessary irritation and concern to the counselor.

Many ambiguities result from overlapping treatment of the same general topic in the "old" law and in newer sections such as the 1938 act. Often the old and the newer law are not patently inconsistent, but they do not readily mesh with one another, and the reader is left in the dark as to the exact effect of the later legislation on the earlier. The annotations to your present code reveal numerous

7. See Hackney, *Accounting Principles in Corporation Law*, 30 LAW & CONTEMP. PROB. 791 (1965).

8. GA. CODE ANN. § 22-723.

instances of uncertainty on the extent to which earlier legislation has been superseded.

One of the most serious faults of Georgia's legislation is its complete failure to deal with the needs and problems of close corporations — the family corporation, the one-man company, and the so-called "incorporated partnership" with a relatively few shareholders. This kind of corporation (rather than the large public-issue, General Motors type of corporation) is the concern of most Georgia lawyers. Indeed most business lawyers everywhere deal more often with close corporations than with public-issue corporations.

Before World War II neither the legislatures nor the courts in this country recognized the distinctive problems of close corporations. Statutes and judicial decisions laid down the same rules for public-issue corporations and for close corporations, even though the needs and methods of operation of the two kinds of corporations were utterly different. Consequently many corporate concepts and statutory provisions (undoubtedly created with public-issue corporations primarily in mind) are ill-adapted to close corporations. In recent years, however, legislatures in a number of states have attempted to evolve rules and concepts to solve the problems of close corporations.⁹ Nothing along this line has been done in Georgia.

Let me give you two illustrations of Georgia deficiencies. In a close corporation the participants often want to depart from traditional corporate management patterns and agree among themselves on how control of the corporation is to be allocated. They may enter into a shareholders' agreement containing the following items:

1. How the shares of the parties to the agreement are to be voted in elections of directors.
2. Who are to be the officers of the corporation.
3. Long-term employment arrangements for some or all of the participants.
4. The salaries to be paid shareholder-officers.
5. The power one or more of the participants is to have to veto corporate decisions.
6. The circumstances in which dividends are to be declared.
7. A method of resolving corporate disputes, e.g., an arbitration provision or some method for dissolving the corporation in the event of dissension or deadlock among the shareholders or directors.

Much more often than most lawyers realize, the validity of shareholders' agreements of this kind are successfully challenged in the

9. O'NEAL, CLOSE CORPORATIONS § 1.14 (Supp. 1966).

courts. The validity of a shareholders' agreement which attempts to determine some of the matters mentioned above is open to question, for example, because it takes away from the directors important decision-making powers traditionally within their province.¹⁰

A number of states have enacted statutes dealing with the validity of this type of agreement. Georgia has not done so.

"Deadlocks" frequently occur among the shareholders and in the directorates of close corporations. The distribution of voting shares in close corporations is often such that an eventual impasse is probable. In some instances the shares are equally divided between two shareholders or groups of shareholders. Wherever directorates have an even number of members — not an uncommon occurrence — even divisions among the directors are likely to occur. Further, persons who are to hold minority interests in closely held enterprises, in an effort to protect themselves against the power normally vested in shareholders and directors to determine corporate policy and to make decisions by simple majority vote, often bargain for and obtain a veto over corporate policies and decisions. These veto arrangements may take the form of high quorum requirements for shareholder or director meetings or of high vote requirements for shareholder or director action. The granting of veto powers to some or all of the shareholders of course greatly enhances the risk of corporate paralysis.

Many jurisdictions, including most of the leading commercial and industrial states, have statutes called "dissolution-on-deadlock" statutes,¹¹ specifically authorizing the courts to dissolve corporations whenever a deadlock develops in shareholder or director voting. Georgia does not have a provision of this kind.

Now let us take a look at a number of miscellaneous changes that some states have made in their statutes.

Statutes Authorizing One Incorporator or Less than Three Directors. In most states in this country, the number of incorporators required for the organization of a corporation is three. At one time, the number was higher — five or seven. Actually, however, the real parties in interest often do not serve as incorporators. The lawyer organizing a corporation often uses "dummy" incorporators, perhaps young lawyers or secretaries in his office. However, such accommodation incorporators may suffer possible liability.¹² One-man companies, in which one person owns all the shares, have long been recog-

10. O'NEAL, CLOSE CORPORATIONS § 5.16 (1958).

11. *E.g.*, N.Y. BUS. CORP. LAW § 1104; N.C. GEN. STAT. § 55-125 (1965).

12. See Note, 47 CORNELL L.Q. 443 (1962); Note, 5 SANTA CLARA LAW 202 (1965).

nized as valid even in the absence of specific legislation. In recent years, however, a number of states have by legislation specifically authorized the formation of a corporation by a single incorporator.¹³

Similarly, a number of recent statutes have departed from the old requirement that a corporation must have at least three directors.¹⁴ These statutes, enacted in 1961 or later, typically provide that the number of directors may be less than three but if less than three, not less than the number of shareholders.

Provisional Director Statutes. A few states, led by California,¹⁵ have enacted provisional director statutes.¹⁶ Where a corporation has an even number of directors who are evenly divided, the statutes authorize court appointment of an additional director who has all the powers of a regularly elected director, until he is removed or the deadlock is resolved. The California statute provides for appointment of a provisional director in an action filed by one-half of the directors or one-third of the outstanding shares, and for his removal by order of the court or action by a majority of the voting shares. The remedy provided by a provisional director statute is much less severe than a receivership, and allows the corporation to end a stalemate and remain a going business. In drafting a corporation statute, consideration should be given to inclusion of a provisional director section.

Statutes Giving Corporations Power to Contribute Funds to Educational and Charitable Activities. Well over 100,000 American corporations now participate in educational and charitable giving. Total corporate contributions are probably running around a billion dollars a year. Federal tax policy encourages corporations to make these contributions.

Corporate counsel have had to be cautious in advising directors and officers of corporations that they can safely expend corporate funds for charitable purposes. The traditional theory, of course, is that the business of a corporation is carried on primarily for the benefit of its shareholders, that its activities must be directed toward profit-making. Thus it cannot expend its funds for purposes which appear to be charitable or humanitarian unless the corporation itself stands to benefit and those benefits can be translated into profits. It is true that the trend even in the absence of statute has been to uphold expenditures even though corporate benefits therefrom are indirect or even conjectural. Nevertheless, no one can be certain that

13. O'NEAL, CLOSE CORPORATIONS § 1.05 (Supp. 1966).

14. *Id.* at § 1.14 (Supp. 1966).

15. CAL. GEN. CORP. LAW § 819.

16. See O'NEAL, CLOSE CORPORATIONS § 9.30 (Supp. 1966).

a court in a particular instance will not strike down a charitable contribution as ultra vires on the ground that it is not calculated to benefit the corporation. Thus, more than three-fourths of the states have enacted permissive legislation expressly authorizing corporations to make gifts to educational, welfare, and scientific institutions.¹⁷ As far as I have been able to determine from a hurried examination of your statutes, Georgia does not have such permissive legislation. This is a vital omission: If a Georgia corporation wants to contribute a couple of million dollars to the Duke Law School, I do not want anything standing in the way! Corporate help is necessary if the private sector of higher education is to remain vigorous.

Statutes Authorizing All-Purpose Corporations. When drafting a corporate charter, lawyers customarily enumerate at length and with great elaboration the purposes and powers the corporation is to have. Lawyers feel that this extensive enumeration assures the corporation of power to engage in any line of activity or to perform any conceivable act that might in the future be expedient. Sometimes after page upon page of purposes and powers the draftsman adds, "and the power to do anything that a natural person can do in any part of the world," and one pictures the corporation committing adultery aboard a ship in the Mediterranean. A few states have now diminished this temptation to use prolix purpose and power clauses by providing for an all-purpose corporation: A corporation can be formed which is authorized to engage in any lawful activity and to perform any act that a natural person can perform, without the customary enumeration of purposes and powers.

Statute Giving Courts Broad Remedial Powers When Minority Shareholders Are Oppressed. The South Carolina Business Corporation Act, passed in 1962, contains an unusual provision, taken from the English Companies Act, which gives the courts exceedingly broad powers as to remedies.¹⁸ The statute provides that if the acts of the directors or those in control of a corporation are illegal or fraudulent or are oppressive or unfairly prejudicial to a shareholder, the court may make such order or grant such relief as it deems appropriate, including an order (1) cancelling or altering any provision contained in the articles of incorporation or in the bylaws of the corporation; (2) cancelling, altering, or enjoining any resolution or other act of the corporation; (3) directing or prohibiting any act of the corporation or of shareholders, directors, officers, or other persons party to the

17. *E.g.*, VA. CODE ANN. § 13.1-3(m) (1964); PA. STAT. ANN. tit. 15, § 716 (1958).

18. S.C. CODE ANN. § 12-22.23 (Supp. 1965).

action; or (4) providing for the purchase at their fair value of shares of any shareholder, either by the corporation or by other shareholders. The section goes on to state that such relief "may be granted as an alternative to a decree of dissolution, or may be granted whenever the circumstances of the case are such that relief, but not dissolution, would be appropriate."

In conclusion, let me say that the statutory developments in other jurisdictions I have mentioned are far from exhaustive. What I have said is certainly not a substitute for a careful study of all recent legislation; it is not even a beginning of the job that needs to be done. The task is tremendous, but it must be done. In Atlanta I see gleaming skyscrapers, modern buildings of all kinds, evidence on every hand of rapid commercial and industrial development; yet your business enterprises either must be organized out of state under the laws of other jurisdictions or they are saddled with corporation statutes that are hardly adequate even for a horse-and-buggy economy, much less for the dynamic twentieth-century society I see all around me.

The ideal corporation statute is not the Model Act, not the New York Statute, not the North Carolina Act. All of these laws have defects. Better than any of these perhaps would be a combination that included parts of all of them. The best corporations statute has not yet been written, at least not the best statute for Georgia. Only the Bar of Georgia can design such a statute, and the job will not be easy. The Corporate Bar must involve itself with this statute because it has the greatest interest in the final product. The drafting of this statute is too important to be left entirely to a few persons. The best statute will be the product of many minds. I eagerly await the results of your labors.