CORPORATION STATUTES: 1959-1966

ERNEST L. FOLK, III*

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* A.B., 1952, Roanoke College; LL.B., 1956; A.M., 1958, University of Virginia. Professor of Law, University of North Carolina at Chapel Hill. Professor Folk has served as Reporter and Draftsman of the South Carolina Business Corporation Act, and since 1964 has been Reporter to the Delaware Corporation Law Revision Committee.
INTRODUCTION

SINCE 1950, when the initial draft of the Model Business Corporation Act was published under the auspices of the American Bar Association, a numerical majority of the states have totally or substantially revised their corporation statutes. The major lines of this development were sufficiently clear that by 1958 a Law and Contemporary Problems symposium could discern an entire "new look in corporation law." After 1960, the pace of revision seemed

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1 In 1946, a draft of what became the Model Act was reported to the Section of Corporation, Banking, and Business Law of the American Bar Association by the Section's Committee on Corporate Laws, but it was 1950 before the text assumed substantially the form in which it has been widely adopted. It has been continuously revised since its 1950 epithany. See 1 MODEL BUS. CORP. ACT ANN. V (1960). The 1960 revision of the Model Act will hereinafter be cited in lieu of the 1953 edition only when amendment has occurred since the latter's publication.

to accelerate, both in the number and importance of the states restructuring their statutes, and in the variety and novelty of the ideas finding expression in the statutes. During this period, New York carried through the most comprehensive revision ever accomplished by any state; Massachusetts, South Carolina, Wyoming, and Arkansas enacted important statutes; Pennsylvania substantially revised its existing law; Florida enacted the first separate close corporation statute, while other states included a variety of special provisions recognizing the peculiar problems of the incorporated partnership; and other states, most notably, Delaware, initiated studies looking towards substantial revision. The Model Act continued to exert great influence. Some states adopted it as if it were a uniform act requiring near identity of provisions in all states, and, indeed, the ABA Committee on Corporate Law has seemed to regard its product as such. All other states have taken account of the Model Act, using it as the point of departure for their own statutes—both by adopting some of its provisions and by reacting to others—with the best statutes extensively supplementing it.

Outside of the United States, the post-1960 period witnessed important statutory revisions and studies. The Jenkins Committee recommended far-reaching amendment of the United Kingdom's 1948 Companies Act; but as of today these 1963 recommendations have not been adopted. In the Commonwealth, Ghana enacted a statute, drafted by Professor L. C. B. Gower, which is the culmination of companies law as developed in Britain and the Commonwealth. Germany's 1937 Aktiengesetz (Stock Company Law) has been superseded by a 1965 enactment, while France, as of the date of writing, has yet to enact its draft Business Associations Law of 1965.

Although this article deduces no metaphysical significance from parallel corporation law revisions in many states and nations of varying levels of economic and political sophistication, there are

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8 Other states enacting new corporation laws are Utah (1961), Mississippi (1962), Nebraska (1962), South Dakota (1965), and Washington (1965), but most of these contain significant provisions noted in this article. States which had enacted statutes prior to 1960 continued to amend their laws in various particulars, some of which are noted. See 1 MODEL BUS. CORP. ACT ANN. 2 (Supp. 1966) (Introduction).
9 Other statutory revisions known to be underway include Georgia and Maryland.
enough new ideas current to deserve analysis. That is the purpose of this article. The take-off date is somewhat arbitrarily rigged at 1959 in order to pick up the finely wrought 1959 Connecticut statute and the Iowa law, which includes many unique and some ill-considered provisions. Currency of the material discussed is limited only by the author's ability to keep up-to-date on new developments and the extent to which he is attuned to the gossip of the trade. Except for novelty of ideas, no particular statutes are selected for special consideration, whether they be corporate law studies and enactments in which the author has had a personal hand, or statutes of great importance such as New York's. Esoteric items, so often tempting to corporate law specialists, will be avoided, within the limits of human frailty. Instead, this article's objective is a selective and critical survey of recent statutes and some guarded projections and suggestions for the future of state corporation law.

I. INCORPORATION PROCEDURE

Gradually, but steadily, incorporation procedure is being simplified in many jurisdictions by deleting ritualistic relics of an earlier day. It seems strange, however, that the streamlining has so slowly evolved, since limited liability through incorporation has long been accepted as an undisputed privilege everywhere. Archaistic formalities originally existed to control if not discourage limited liability; the law's oft-noted tendency to lag behind substantive changes in practice and attitudes presumably explains the slow removal of these now useless and sometimes inconvenient statutory procedures.7

1. Incorporators: Several recent enactments, together with the 1962 draft of the Model Act, authorize a single individual to function as an incorporator.8 Not only does this sound application of Occam's razor recognize the largely formal role of incorporators, but it eliminates any argument that requiring multiple incorporators implies some intrinsic vice in the one-man corporation.9

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few statutes have taken the more advanced tack of eliminating any requirement, express or implied, that an incorporator be a “natural” person. This is sensible when much incorporation is in fact handled by “corporation service companies” who supply incorporators as well as other functional mechanical aids. Although corporate incorporators must act through their agents, this involves little likelihood of contest as to the authority of such persons to act for the incorporator.

2. Articles of Incorporation: A variety of procedures have simplified the preparation of articles of incorporation. A trend developed some time ago to discourage recitals of corporate powers, although sometimes articles may limit the plenary grant of power given by statutes to most corporations. Recitals of purposes still pose problems because of professional prolixity and an ingrained fear that just possibly at some remote future date the serene book store may wish to manufacture rockets or high-speed computers. Although widespread codification of “liberal” rules on ultra vires


\[\text{Wisconsin allows an alternative of whether to name initial directors when the articles of incorporation are filed or to leave the management temporarily to the incorporators with the directors remaining undisclosed until elected later. Wis. Stat. Ann. §§ 180.32, 69 (Supp. 1966). Occasionally, there may be good business (or other) reasons why the real principals do not wish to be immediately revealed as directors, and the Wisconsin statute accommodates this interest.} \]

\[\text{2 Statutes now encourage efforts to keep the articles current and eliminate stale or outdated matter. Permission to restate articles, see ABA-ALI Model Bus. Corp. Act § 59 (1955), is almost always adopted by the newer statutes with some variations. E.g., Mass. Gen. Laws Ann. ch. 156B, § 13 (c) (Supp. 1965) (specifies information “which shall not for any purpose be treated as a permanent part of the articles,” i.e., names of initial directors, date of the annual meeting, name and address of the initial registered agent and the post office address of the registered office, and the corporate fiscal year).} \]

\[\text{See ABA-ALI Model Bus. Corp. Act § 48 (1953) which dispenses with recitals in the articles of the corporate powers. This provision has been widely copied. See 2 Model Bus. Corp. Act Ann. § 48, ¶ 2.01, 6 (Supp. 1966).} \]

\[\text{14 See S.C. Code Ann. § 12-12.2 (a) (Supp. 1965). (Each corporation, unless otherwise stated in its articles of incorporation, shall have the enumerated powers.)} \]

\[\text{15 The prototype provision is ABA-ALI Model Bus. Corp. Act § 6 (1953). N.C. Gen. Stat. § 55-18 (a) (1) (1965) adds to the Model Act provision that in a shareholder’s suit to enjoin an ultra vires act, he must show that he has not at any time} \]
should rationally induce lawyers to be less concerned to cover every possible corporate activity, the inconvenience of amending the charter, at least of a publicly owned corporation, militates in the direction of all-inclusiveness. If the old theory that recitals of purpose are needed as disclosure devices for shareholders and creditors ever had any validity in practice, it is surely meaningless when charter clauses go on endlessly listing activities in which the corporation is not engaged and probably never will be. The actual business done or intended to be done by the enterprise is lost in the paperwork. Since it would only cause more problems to require articles to recite the actual or intended business, it is well to authorize the articles to state “either (1) the purpose or purposes for which the corporation is organized; or (2) that the corporation shall have unlimited power to engage in and to do any lawful act concerning any or all lawful businesses for which corporations may be organized under this act.” Persons interested in the matter can use more informative sources than the charter to discover actual business done.

3. Corporate Powers: The steady enlargement of corporate powers in the newer statutes, coupled with the conventional Model Act section drawing the sting from the old ultra vires doctrine, leaves corporations with virtually all the powers they need or wish. One particular power does require brief comment, however. Even in some traditionally strict jurisdictions,17 statutes empower corporations to enter into partnerships, joint ventures, and the like.18 Two recent enactments are more cautious. Arkansas19 permits partnership agreements only if the charter or a stockholder majority

prior thereto assented to the challenged act and is not acting collusively with the corporate officers in so suing. The North Carolina statute was enacted in 1955.


(absent charter provision) authorizes it, but allows the board alone
to cause the corporation to enter into a limited partnership or to
form a "joint adventure arrangement." The latter is limited to
either "the joint prosecution of a single undertaking" or "prosecu-
tion of successive joint undertakings or business activities over a
period not exceeding five (5) years."20 Virginia requires a vote of
two-thirds of all shares, voting and non-voting, unless authorized by
charter, in order to validate partnership arrangements.21

As one looks at the newer statutes, one discerns the logical con-
sequence of vesting corporations with "all the powers of a natural
person of full capacity."22 This is the language of the Companies
Code of Ghana which, in Professor Gower's view, "makes for brevity
and simplicity and probably produces rather greater certainty,"
since it avoids necessarily lengthy enumeration of specific powers
and the need for some general catchall clause of residual power.23
A 1965 Minnesota amendment seems to have gone further than any
American jurisdiction in authorizing the articles to state that the
corporation "shall have unlimited power to engage in and to do any
lawful act concerning any and all lawful businesses for which corpo-
rations may be organized under the statute."24

This provision is, indeed, unusual, since most American statutes
disapprove the creation of the "all purpose" corporation with capac-
ity to exercise unlimited powers. Hence, many statutes explicitly
subordinate many powers to the corporation's stated purposes,25 al-
though authorizing others to be exercised without regard to pur-
pose.26 But assuming skillful draftsmanship, this is just a difference
in form and terminology, since the sum of corporate powers granted
by the statutes is plenary, and charters often authorize every con-
ceivable sort of business the corporation might wish to conduct.

One cannot reasonably doubt the good sense of enlarging corpo-
rate capacities, and then shifting policy questions away from debate
as to whether the corporation does (or should) have the power to

20 Ibid.
22 Companies Code, 1961, § 24 (Ghana).
23 Ghana Rep. 41.
24 MINN. STAT. ANN. § 301.03 (Supp. 1965); see also MINN. STAT. ANN. § 301.04(1)
25 E.g., N.Y. Bus. Corp. Law § 202 (a).
26 E.g., CONN. GEN. STAT. ANN. § 33-291 (1960), as amended, § 33-291 (e) (Supp.
1965).
whether the power should be curbed or controlled in some way as a matter of policy.27 Thus, for example, a corporation (like any principal) would have the general capacity to indemnify when, whom, and how it wishes, but a statute would properly address itself to appropriate limits on this power as measured by policy factors.

4. Recordation Requirements: Several recent revisions have simplified the incorporation process (and, indeed, all requirements for public disclosure of essential corporate documents) by modifying traditional requirements that documents be locally recorded as well as centrally filed. Earlier, most states had stipulated, in one way or another, that failure to record articles of incorporation would not imply lack of de jure corporate status requiring recourse to the cloudy and uncertain de facto doctrine with its various distinctions.28 A few states have eliminated local recordation (if indeed they ever had it) so that central filing is sufficient.29 Others have yielded to expected pressures to retain recordation but only require central filing and direct the central office to transmit the papers for local recordation.30

The chief argument for retaining local recordation—apart from vested interests of local officials and districts in recordation fees—is its convenience to local attorneys and, particularly, title searchers. However, the document will be recorded only in the county where the corporation’s registered office is located, although the corporation may be doing a multi-county business, so that recordation, somewhat accidentally, serves the convenience only of an attorney practicing in the county where the office is situated. Actually, where a small monetary penalty is the only sanction—as, indeed, it should be—there is less incentive for prompt local recordation, so that the attorney or title searcher cannot be certain that a necessary docu-

27 Such is the case in the Arkansas and Virginia limitations on powers to enter partnerships. Notes 19, 21 supra and accompanying text.
28 This was typically accomplished by language indicating that filing of the document consummated the transaction even though the document was not recorded—failure to record resulting in only a monetary penalty. E.g., N.C. Gen. Stat. § 55-4 (b) (1965). A recent example is Ark. Stat. Ann. § 64-117 (B) (1966).
30 E.g., Minn. Stat. Ann. § 301.07 (1947); N.Y. Bus. Corp. Law § 104 (g).
ment has been locally recorded. Thus, even where it is demanded by statute, a prudent attorney would still inquire at the central filing office, since the absence of the document in the local file does not establish the existence or non-existence of the corporation. In title searching, reliance upon local recordation is well placed only if (1) the title being searched is for land located in the county of the registered office, and (2) it is certain that the document has in fact been locally recorded. Many local corporations will have land in more than one locale, and since the document may not in fact be locally recorded, the title searcher would be foolish to draw a firm conclusion if he fails to turn up a particular document.

5. Organization Meeting: This “meeting” is often a paper transaction—a set of minutes signed by all parties. The newer statutes rightly validate this procedure, since the organization meeting is seldom one in which the parties need to get together face-to-face and exchange ideas or elicit a consensus from conflicting views. In all events, where the statute requires a directors’ organization meeting, the increasingly common provision for informal director action—finally adopted even by the Model Act—sanctions this procedure; and in other states where the incorporators “organize” the corporation, special provisions, as in New York, will validate such procedure. In either case, statutes retain the fiction that someone takes “action,” and that the signed documents reflect “the action so taken.”

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22 At least two recent statutes specify in mandatory terms the duty of the Secretary of State to file documents and in effect withdraw any discretion not to accept them. Thus, Pa. Stat. Ann. tit. 15, § 2852-10 (B) (Supp. 1966) requires filing if the Department of State finds the document is duly executed, the corporate name available, and taxes, fees, and proof of publication tendered. The genesis of this provision was S.C. Code Ann. § 12-14.4 (Supp. 1965). Several states authorize the articles of incorporation to state a post-filing effective date, usually not more than ninety days after filing. E.g., Fla. Stat. Ann. § 608.041 (I) (Supp. 1965); Iowa Code § 496A.49 (12) (1962).

Although the discussion of recordation requirements is developed more than the intrinsic merits of the provisions warrant, it is desirable to dispel the empty arguments asserted in support of the requirement. In all events, presumed convenience of title searchers should be subordinated to the corporate interest in quick and flexible incorporation procedures.

25 N.Y. Bus. Corp. Law § 404 (b).
26 Ibid.
It would be simpler to dispense with the fiction and state that the corporation has been "duly organized" when a document containing by-laws and designating the initial officers (or directors, or both) has been signed by the appropriate persons. After all, we have pretty well eliminated any fiction that incorporators or subscribers or promoters have "adopted" or "acted upon" or "approved" articles of incorporation before filing them. In sum, the incorporation process could be simplified further, both linguistically and in practice, simply by statutory statements solely in terms of signatures to documents, some of which must be filed, coupled with payment of a minimum capital. Such simplicity of statement and practice is codified in the Draft Companies Law of Israel.8

Following the Model Act, most new corporation statutes distinguish between (1) the coming-into-being of the corporation (typically accomplished by centrally filing the articles) and (2) beginning to do business (contingent upon payment of a nominal capital). This creates certain complexities since the statutes and cases must enumerate the liabilities of parties when there is (1) defective incorporation or (2) failure to pay in capital.

6. "De Facto" Doctrines and "Estoppel": It seems generally assumed that adoption of a Model Act-type provision inaugurating corporate existence on issuing the incorporation certificate, which is also declared "conclusive evidence" of incorporation,38 eliminates the concepts of "de facto" corporate existence and "estoppel" to deny corporateness.39 Thus, the Model Act draftsmen observed that "since it is unlikely that any steps short of securing a certificate of incorporation would be held to constitute apparent compliance, the possibility that a de facto corporation could exist under such a provision is remote."40 If this widely adopted Model Act provision is intended to displace these supplementary judicial doctrines, it has not succeeded; only the focus of the problem has shifted. It may well be that the doctrine of "de facto corporation" has no further

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87 Israel Draft Companies Bill § 2 (1957) states: "For the purpose of forming a company, there shall be filed with the registrar through an advocate—(1) the proposed Rules and an application for registration, signed by all the founders; (2) a list of the first directors, signed by each of them; (3) notice of the address of the registered office." Under § 4, "from the date of registration the company shall be a legal body, capable of liabilities, rights and legal actions."


role to perform. This interpretation is compatible with the statistical showing that absence of central filing carries the greatest probability that a *de facto* corporation would not be judicially erected. Particularly in a jurisdiction which only requires central filing, invoking the *de facto* doctrine on the basis of something less than filing would violate the statutory purpose. The same result should follow even where local recordation is still required.

The effect of this Model Act provision on the related “corporation by estoppel” concept is less certain, and the few returns so far received reveal judicial conflict. In one of the several jurisdictions which have coupled Model Act section 50 with section 139—making personally liable “all persons who assumed to act as a corporation without authority so to do”—at least one court has held that estoppel concepts are abolished by this statutory combination. There is much to be said in favor of this clear-cut result: file the documents and one enjoys limited liability (subject to paying in minimum capital), but fail to file and he lacks “authority” to “act as a corporation” and therefore is subject to partnership liability. Absent section 139, the question is whether “estoppel” concepts survive enactment only of section 50. The Maryland court has held, without reference to its version of this statute, that an individual officer of a defectively organized corporation could plead estoppel to bar suit against him. This result seems appropriate so long as the statute does not impose partnership liability. The public policy of compelling due filing of corporate documents is not so overwhelming as to demand abolition of all estoppel concepts with the concomitant result of imposing strict personal liability on the parties who may have innocently acted on a supposed corporate basis. Absent legislative clarity on the matter, section 50 should be read only as stating that after a certain event the corporation “exists,” but not as implying that, in all other circumstances, limited liability is precluded. Without the equivalent of section 139, sec-

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43 ABA-ALI *MODEL BUS. CORP. ACT* § 50 (1953) makes filing the articles conclusive of the fact of incorporation.
44 ABA-ALI *MODEL BUS. CORP. ACT* § 139 (1953).
tion 50 should not be construed as ipso facto removing the traditional discretionary power of courts to decide particular cases so as to implement reasonable expectations and promote the security of transactions.

It is apparent, then, that the recent statutory enactments—other than those which purport to declare partnership liability for persons not complying with filing procedures—have not settled the question of the extent to which the de facto and estoppel doctrines continue to apply. Given the ease with which corporations can be formed, it would seem desirable now to draft a statute making filing an absolute prerequisite for limited liability and imposing partnership liability when compliance is not proven, thereby definitively abandoning the old and uncertain common law doctrines of de facto corporation and estoppel.

7. Doing Business Before Receiving Capital: Assuming that a corporation is duly formed, the newer statutes usually disable it from doing business before a minimum amount of capital is paid in. Thus, payment of nominal capital is now a pre-condition only of doing business rather than, as in some older statutes, a prerequisite of corporate status. The Model Act,\(^\text{48}\) typifying most newer statutes, makes no advance in protecting creditors, and indeed it is doubtful that this should be a proper function of the incorporation provisions. Most statutes require only a nominal capital, if any at all,\(^\text{49}\) and exact only a liability to pay the unpaid portion of this minimum capital.\(^\text{50}\) Thus, if, as is possible in some states, a corporation may start doing business with a one dollar capitalization,\(^\text{51}\) the statutory liability is only for a maximum of one dollar. Whether or not this will induce courts to extend the common law authority subjecting an insider of a grossly undercapitalized corporation to personal liability will depend largely upon whether courts read the

\(^{48}\)ABA-ALI MODEL BUS. CORP. ACT § 51 (1953) ($1,000 required to be paid in).

\(^{49}\)The range of dollar figures for those jurisdictions requiring payment of a dollar amount appears in 2 MODEL BUS. CORP. ACT ANN. § 51, ¶ 2.02 (2) (1966, Supp. 1966). The amounts vary from $200 (Georgia) to $1,000 (Utah, South Dakota, and a number of other states which revised their laws prior to the cut-off date here discussed). No minimum capital is required in North Carolina. N.C. GEN. STAT. § 55-7(5) (1965).

\(^{50}\)See, e.g., ABA-ALI MODEL BUS. CORP. ACT § 43 (c) (1953).

\(^{51}\)The familiar case of Weisser v. Mursam Shoe Corp., 127 F.2d 344 (2d Cir. 1942), involved a corporation which launched its operations with just such a munificent capital contribution.
statutorily required minimum capital as abrogating any common law liabilities.

The problem is one which corporate law revisers have given up on, hoping that commercial practice, availability of information, and creditor self-interest will take up the slack. Some states do require a minimum dollar amount, and arguably such an amount would deter courts from exacting additional personal liabilities under common law. The difficulties are that any amount which would protect creditors is too large to be practical and politic; and, absent strict controls, any amount paid in, large or small, can still be removed by reductions of capital. Perhaps a required dollar amount (say $1,000) may occasionally deter a few shoe string enterprises, although any such consequence would be hard to predict and harder to verify. At least one jurisdiction imposes personal liability on directors not only for the minimum capital promised in the articles, but also for corporate debts incurred until the initial stated capital has come in. Once again, this safeguard may be more in terrorem than real since such quasi-partnership liability may be avoided simply by making (and then withdrawing by impeccable compliance with statutory procedures) the minimum capital, for nothing in the typical statutes compels retention of the minimum capital once paid in.

8. Promoters' Contracts: Although some efforts, not wholly adequate, would substitute a statutory rule for the unsatisfactory common law concepts of de facto corporation and corporation by estoppel, nothing has been done in recent corporation revisions to clarify the equally chaotic law on promoters' and other pre-incorporation contracts. This is indeed unfortunate since the promoter, not inevitably a "bad guy," is an indispensable figure in forming a corporation. Often—probably most often—the "promoters" of a

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59 See note 49 supra.
60 S.C. CODE ANN. § 12-14.6(b) (Supp. 1965).
61 See note 49 supra.
62 But cf. MINN. STAT. ANN. § 301.04 (6) (Supp. 1965) (requiring $1,000 minimum capital) and § 301.39 (5) (Supp. 1965) (forbidding reduction of capital below the $1,000 minimum).
63 The only two statutes attempting to meet the problem are old. They are MICH. STAT. ANN. § 21.18 (1963) and KAN. GEN. STAT. ANN. § 17-2807 (1964). Their inadequacies have been exposed in Kessler, Promoters' Contracts: A Statutory Solution, 15 RUTGERS L. REV. 566, 576-81 (1961).
64 Pre-incorporation subscription contracts have fared better under most new statutory revisions. ABA-ALI MODEL BUS. CORP. ACT § 16 (1963); CONN. GEN. STAT. ANN. § 33-542 (Supp. 1965); N.Y. BUS. CORP. LAW § 503; S.C. CODE ANN. § 12-15.5 (Supp. 1965).
close corporation, and frequently those of a small enterprise looking
towards a moderate public investment, will be the businessmen who
are seeking to launch a bona fide enterprise, perhaps from scratch
or perhaps as successor to a sole proprietorship or partnership.
Stressing this aspect of "promotion," Professor Kessler has compre-
hensively restudied this area of the law to assess the merits and
demerits of the common law rules and has evolved a useful draft
statute which would mark a great advance over the common law,
certainly as to clarity and, in large measure, as to substantive mat-
ters. The heart of his proposal would relieve a promoter, even
before incorporation, from liability on a promoter's contract (as he
defines the term) if the contract itself discloses that a corporation
is to be organized and if no clause makes the promoter a party to
the agreement. The corporation automatically succeeds to the con-
tract unless it repudiates it within eight days after either incorpo-
ration or acquisition of full knowledge of the contract terms, whichever is later. The draft statute also spells out corporate obligations
on repudiation. A particular strength of the statute is its providing
a rational pattern of risk distribution which may be freely varied
by the parties.

The Republic of Ghana is apparently the only jurisdiction
rooted in Anglo-American law to adopt a statutory rule for pro-
moters' contracts. Much simpler than the Kessler proposal, it first
authorizes ratification of a promoter's contract, thereby eliminating
a hypertechnical agency rule requiring a principal's existence at the
time of the contract, and second, declares the promoter personally
bound on, and benefited by, the contract prior to ratification. In
this respect, the Ghana statute inverts the Kessler proposal, which
relieves the promoter from all liability absent language making him
a party. The choice is not critical so long as each statute permits
contractual variation. The Ghana statute unfortunately leaves open
the common law question of a promoter's continuing liability after
corporate ratification. Even if the language implies a novation upon

67 Kessler, supra note 55, at 605-06.
68 See Companies Code, 1961, § 13 (Ghana); Ghana Rep. 32. Section 12 of the
Ghana Companies Code is a strong reaffirmation (and extension) of the fiduciary
duties of promoters. Section 12(4) entitles the corporation to rescind a transaction
between the promoter and the company unless there has been full disclosure of all
material facts known to the promoter plus approval or ratification by an independent
board of directors or by all the shareholders or by the "general meeting" of the
company without counting votes of or controlled by the promoter.
ratification—and this is uncertain—there is no reason for not establishing the fact explicitly.69

II. MANAGEMENT: DIRECTORS AND OFFICERS

1. Compensation: The aid-to-directors movement has now so exhausted itself in an orgy of indulgence and favoritism that little more remains to be done on the state level. This is illustrated by the fact that the forms and varieties of compensating directors and officers are now limited, for practical purposes, only by federal tax laws and even then only incompletely. Virtually all recent state revisions adopt the Model Act’s expansive grant of power to compensate “directors, officers and employees.”60 Besides conventional monetary forms of compensation, Colorado grandly authorizes “education, housing, social and recreational services, and other similar aids and services” to directors, officers, and employees of the corporation or of any subsidiary.61 Although not a product of the most recent revision, Pennsylvania overcomes even this limitation by authorizing “allowances or pensions” not only to directors, officers, and employees, but also “after their death, to their dependents or beneficiaries, whether or not such a grant was made during their lifetime.”62 This dispenses with arguments that widows’ consolation prizes are really a form of compensation to an employee, particularly when no such arrangement was bargained-for during the employee’s lifetime.

Whatever the merits of corporate generosity to widows, current tendencies to treat families of related corporations on a system or consolidated basis makes it sensible for statutes to empower the parent to compensate the subsidiary’s directors, officers, and employees and particularly to authorize use of personnel options to acquire the parent’s shares. There may be a ready and active market for the parent’s shares (e.g., American Telephone and Telegraph Co.) but not for the subsidiary’s shares (e.g., Western Electric Co.); moreover, the parent corporation may reasonably wish not to dilute its complete or near-complete stock control by putting stock of the

60 The Kessler proposal need not resolve this problem since the promoter is not liable at all absent contrary agreement. However, the issue would arise if the contract did stipulate for continuing, i.e., post-incorporation and post-ratification, liability, and the corporation was unable or unwilling to perform thereafter.


62 PA. STAT. ANN. tit. 15, § 2852-316 (1958); see also WIS. STAT. ANN. § 180.31 (1957).
subsidiary in other hands. The Virginia statute, which antedates the period primarily considered, broadly provides for compensation by, and stock options from, parent corporations for personnel of corporate subsidiaries.

Boards of directors now almost always enjoy the Model Act privilege of fixing compensation for themselves in both director and officer capacities, usually exempt from statutory (and presumably common law) controls on "interested director" transactions. Running counter to this trend is Utah's voice in the wilderness, exacting for such freedom the moderate price of mandatory disclosure to the shareholders of the facts concerning compensation except when the corporation is subject to the SEC proxy rules where, presumably, there will be sufficient disclosure.

2. Directors' Liabilities: Virtually all new statutes adopt the Model Act provision which specifies various director liabilities for improper dividends and other distributions and which grants certain defenses, among them good faith reliance on books and records and also on financial statements represented to be correct by the appropriate officer or certified by independent accountants. Iowa apparently feels these standards are too stringent, and therefore makes directors liable only if they acted "in willful or negligent violation" of the statute or restrictions in the articles of incorporation.

Of the few revisions which codify the directors' general duty, there are subtle variations. Thus the statutes generally agree that all directors must act "in good faith and with that degree of diligence, care and skill which ordinarily prudent men would exercise under similar circumstances in like positions." However, these few statutes vary either in not naming the beneficiaries of the duty, or in stating that the duty runs only "to the corporation" or "to

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67 Iowa Code §§ 496A.44 (1), (2) (1962).
69 N.Y. Bus. Corp. Law § 717.
the corporation and to its shareholders.”\(^7\) The latter formulation certainly strengthens the hand of shareholders in the unfortunately frequent situation where insiders act from their strategic position upon uncommunicated knowledge to buy “outside” interests at favorable prices or where insiders otherwise use their vantage point to force minority interests out of the corporation.\(^7\)

Even in the jurisdictions where paper declarations of fiduciary duties are strongest, there may be real practical problems of obtaining jurisdiction over non-resident directors. Sequestration has often been an effective method in Delaware,\(^7\) but that state is, understandably, experiencing pressures to drop such a means of bringing non-Delawarans into the Court of Chancery. The most effective remedy, that is, a non-resident director statute, has been adopted since 1959 by Connecticut\(^7\) and South Carolina,\(^7\) and earlier by North Carolina.\(^7\)

3. *Interested Director and Officer Transactions:* Relatively few new statutory revisions have dealt with transactions by interested directors and officers or by corporations with interlocking directorates, although the common law is confusing and needs clarification and, for some jurisdictions, correction. Although some pre-1960 statutes effectively treated the problem, most notably California\(^7\) and North Carolina,\(^7\) since that date Connecticut,\(^7\) New York,\(^7\) and South Carolina\(^7\) seem to have been the only states to deal directly with the problem.

(a) *Persons Affected by Statute:* All of the statutory provisions


\(^7\) Elsewhere, in analyzing the North Carolina provision making fiduciary duties run to shareholders as well as to the corporation, I have suggested that such language might well induce a court in such a jurisdiction to decide in favor of shareholders several issues which recently have gone against them. See Folk, *Revisiting the North Carolina Corporation Law,* 43 N.C.L. Rev. 768, 796-802 (1965).

\(^7\) This procedure for attaching shares of stock and requiring the director-owner to defend the main action in Delaware is in large measure based on Del. Code Ann. tit. 8, § 169 (1952), which states that the situs of shares of stock in a Delaware corporation remains in Delaware. See also Del. Code Ann. tit. 8, § 324 (Supp. 1964).


\(^7\) Cal. Corp. Code § 820.


\(^7\) N.Y. Bus. Corp. Law § 713.

apply at least to transactions between a director and his corporation and, with some variations, to transactions between a corporation and some other entity in which a director of the corporation holds a post or has a financial interest. Two statutes go beyond this minimum. Connecticut includes transactions involving "a member of [the director's] immediate family," whether directly with the corporation or with some other entity in which a family member has an interest. South Carolina's statute embraces both transactions between a corporation and one of its officers and transactions between corporations (or other entities) with common officers. None of these statutes purports to deal with non-officer personnel such as controlling or dominant shareholders; nor does any statute specifically deal with a transaction between a corporation and a nominee of a director or officer. However, since courts will not likely overlook the extent to which subterfuge would defeat a salutary rule of law, they may impose liability on nominees or others controlled by or acting for a true insider, and perhaps also on one not technically an officer or director but enjoying access to confidential information.

(b) Transactions Affected by Statutes: All of the statutes use sufficiently indefinite terms, such as "transaction" or "contract," to include all sorts of arrangements between a corporation and "interested" persons. Usually, the statutes exempt from coverage that very important "transaction" of fixing compensation. The older North Carolina provision stipulated a test, not adopted by later statutes, defining "just and reasonable" compensation as "what would be paid for such services at arm's length under competitive conditions."

(c) Statutory Tests for Validating Transactions: The heart of these statutes—whatever transactions they cover and to whomever they apply—comprises three disjunctive clauses, varying in language but following an identical pattern: (1) disinterested director ap-

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82 See notes 86-87 infra and accompanying text.
85 Statutes which refer to a "financial interest, direct or indirect," e.g., S.C. Code Ann. § 12-18.16 (b) (2) (Supp. 1965), probably lend themselves more readily to sweeping subterfuge arrangements.
86 N.Y. Bus. Corp. Law § 713 (c) (absent certificate or by-law provision); S.C. Code Ann. § 12-18.16 (e) (Supp. 1965) (same). See notes 64-65 supra and accompanying text.
proval, or (2) shareholder approval, or (3) proof of fairness of the transaction.

The clause requiring disinterested director approval seeks protection in disclosure to directors and their lack of economic interest in the transaction. New York requires authorization by disinterested directors or committee members, but it is much too weak in requiring only disclosure or knowledge of "the fact of such common directorship, officership or financial interest."88 This contrasts with South Carolina's forcing not only disclosure of "the material facts as to his interest" but also those "as to the transaction."89 The Connecticut provision is less direct since, besides mandating a disinterested majority to authorize a transaction, validation depends on showing that the transaction "is not manifestly unfair as to the corporation."89 The South Carolina and Connecticut approaches vary somewhat, but each is superior to New York's in not allowing a director, in effect, to say: "I own forty-five per cent of the stock of T Corporation with whom this contract is made," and then to keep silent as to material features of the contract about which he alone may know or be able sufficiently to interpret in the light of his knowledge of the affairs of both contracting parties. Presumably, a statute so limited as New York's will be judicially glossed with some requirement of "good faith" over and above disclosure of the fact of the interest, although it would seem unwarranted for the court, absent further statutory provision in this subsection, to read in a full "fairness" test.

On the second requirement—shareholder approval—New York again adopts an inadequate provision, for it requires only disclosure of the "common directorship, officership or financial interest" and approval by a shareholder vote.91 The same criticisms proffered above apply here, and indeed, this statutory test which says nothing about disclosing material facts of the transaction is less rigorous than would be expected for common law ratification. Additionally, unlike its director-authorization provision, New York requires no disinterested majority of shareholders. Nor does the Connecticut

88 N.Y. Bus. Corp. Law § 713 (a) (1). Even the otherwise tight North Carolina provision refers only to "knowledge on the part of the other directors." N.C. Gen. Stat. § 55-30 (b) (1) (1965).
91 N.Y. Bus. Corp. Law § 713 (a) (2).
statute which reaches the same result since it does not incorporate its “manifest unfairness” test into this part of the statute. The archetypal California statute does require “good faith,” and we can hope that this would be read into the New York and Connecticut provisions. South Carolina, following North Carolina, takes the strictest position by requiring approval by a majority of the disinterested shares. Presumably this provision does not readily commend itself to other states because of its strictness and the possible administrative difficulties of determining which shares have a disqualifying interest.

The residual test in each statute is whether the transaction is “fair and equitable” (South Carolina), “fair and reasonable” (New York), or just “fair” (Connecticut), as of the time of the transaction rather than in retrospect. On this point, there is no significant variation, except that the South Carolina statute specifically puts the burden of so proving on the proponent of fairness, who would normally be a director or officer. There is much to be said for such a statutory resolution of this potentially vexatious question since courts have disagreed in the past as to whether the plaintiff (usually the suing shareholder) must prove unfairness or whether the defendant (often the director) must bear the burden of proving fairness; the latter is preferable since the insider is better positioned to bring to light the pertinent facts.

(d) Common Directors: Two statutes—Connecticut and South Carolina—relax the rules for sustaining a transaction between corporations with interlocking directors. Connecticut validates the transaction either if it “is not manifestly unfair” to the corporation which attacks it or if a majority of the voting shares have approved it. South Carolina takes a different approach by requiring fairness but placing the burden of proof on the party asserting unfairness. The presumed fairness of a contract made by interlocked boards accords with New York decisional law and presumably will

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92 CONN. GEN. STAT. ANN. § 33-323 (a) (2) (1960).
93 CAL. CORP. CODE § 820 (b).
carry forward under its new statute, which is silent about the burdens of proof in the interlock situation.

(e) Quorum: New York\(^{100}\) counts interested directors towards a quorum, while South Carolina has a like rule for determining a quorum at both directors' and shareholders' meetings.\(^{101}\) It seems reasonable to let a directors' or shareholders' meeting organize unembarrassed with quorum difficulties; indeed, it might be impossible to assemble a quorum if interested directors or shares could not be counted. Safeguards come, not through perpetually blocking a quorum, but from requirements of full disclosure and disinterested voting. And finally, as the Delaware court once observed in a related situation, "questions of alleged unfairness or inequity" may always be decided by the courts and will remain "untouched" by a charter clause permitting interested directors to help make a quorum.\(^{102}\)

(f) Miscellaneous Points: All of the statutes apply when a director has a "financial interest" or a "substantial interest" in the transaction; but only Connecticut explains this concept by enumerating "exclusions" from a general definition.\(^{103}\) So complex is the interplay of the resulting definition with the rest of the statute that the scope of the statute is elusive. Counsel should probably follow a simple rule of advising client-directors: "When in doubt as to whether you have any interest, disclose it and put it on the records."

New York and South Carolina do not specify the relief which the courts may give if the transaction is declared "void or voidable." It is assumed that rescission or perhaps director liability is in order. Connecticut wades into this difficult matter by authorizing rescission or damages or both, properly guaranteeing that "the rights of third parties shall be protected."\(^{104}\) Elsewhere it is stated that, if any of the tests of validity are met, "such director shall not incur any liability."\(^{105}\) Does this carry a negative implication that if the tests are not met, the director does (or may) "incur liability"? However, it does not follow that because a transaction should be rescinded for interest, personal liability should be incurred; and,
indeed, a leading New York decision has clearly distinguished the two remedies. Indeed, the language seems to raise a problem which it does not solve.

4. **Number of Directors:** While several states statutorily require a minimum of three directors, other jurisdictions now authorize a lesser number equal to the number of shareholders which may be as few as one or two. Wyoming, alone among these states, takes the desirable further step of requiring the articles of incorporation of an enterprise with a one or two-man board to specify the number of directors if the number of shareholders should increase beyond one or two.

The states enacting one or two-man director statutes are split on whether to count only record or to include beneficially held shares. Delaware, New York, and Wyoming, for example, require that all shares be owned “beneficially and of record” by fewer than three shareholders, while Illinois and Nebraska look only to record ownings. Thus, if all shares were owned of record by one natural person and by a trust with two beneficiaries, Delaware would require three directors while Illinois would accept two. The balance of convenience favors deleting the beneficial owner requirement since no overwhelming reason appears for exacting it. On the contrary, the likelihood of abuse seems slight, and the exact type of abuse flowing from so small a number of directors is not altogether clear. Moreover, as the example illustrates, the Illinois approach is more flexible. It becomes possible to determine solely from the corporate records whether the statutory conditions validating a one or two-man board are present. Even though in a close

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70 The best discussion of this topic is Rudolph, Further Thoughts on the One and Two Director Statutes, 20 Bus. Law. 781 (1965). I, for one, am glad to concede Wyoming’s “plaintive claim to parentage” for the one and two-director statutes, see Rudolph, supra at 782, despite my earlier supposition that Delaware fathered the idea, see Folk, The Model Act and the South Carolina Corporation Law Revision, 18 Bus. Law. 351, 364 (1963). Surprisingly, the state which pioneered so much close corporation law has never provided for less-than-three-men boards. N.C. Gen. Stat. § 55-25 (a) (1965).
corporation the parties presumably know who owns the stock, it does cause some uncertainty and may impair the reliability of corporate action by a small board if one must look beyond corporate records for facts of beneficial ownership, often concealed and otherwise difficult to determine. Of course, the potential hardships are allayed by the fact that outsiders ignorant of beneficial ownings would presumably be protected in dealing with a board of a size which appears to meet the statutory conditions. Perhaps the most compelling reason favoring a record ownership rule is that the validity of corporate action could otherwise be put in doubt (both as to outsiders and insiders) by events beyond the corporation’s control (or knowledge) since one shareholder could subdivide his shareholdings and thus, unknown to the corporation, destroy compliance with the statutory condition.112

It is interesting to notice that apparently no state has considered how the statutory requirement of number and identity of officers fits in with a one or two-man corporation. Conventionally, statutes require, as a minimum, a treasurer, a secretary, and a president, but they normally forbid combination of the latter two offices.113 The two-man corporation can readily conform. A one-man corporation obviously cannot literally comply, but generally corporate action is valid if taken by unanimous directors and/or shareholders, who, in this case, would be the lone shareholder-director.114 However, with the single shareholder corporation it would seem desirable to eliminate any requirement of offices at all or to expressly permit all offices to be held by one person.115

Apart from the one or two-shareholder enterprise, it might be desirable to permit a multi-shareholder corporation to operate with one or two directors. Two American statutes so provide,116 and the English Companies Act authorizes a single director for a private

112 Thus, where beneficial ownings must be counted, the corporate documents should include a type of transfer restriction to block alienations of beneficial interest in order to avoid the clandestine transfer problem.


114 Compare S.C. Code Ann. § 12-11.4(b)(2)(D) (Supp. 1965) authorizing, as a general principle, that documents may be executed “by the holders of all the outstanding shares of the corporation.”

115 Iowa Code § 496A.45 (1962); Panama Gen. Corp. Law art. 66.

company and a minimum of two directors for other companies. In some situations equally divided shareholdings may be able to get together on a single "managing director" of the British type, perhaps an independent outsider, rather than stymie all action with an incompatible two-man board. In all events, the fact that such a scheme could serve a small enterprise in some situations would itself commend statutes which allow the extra flexibility. Whether or not cumulative voting is mandatory or permissive in a given jurisdiction should largely determine whether a statute should authorize a one or two-man board for a corporation with more than one or two shareholders respectively, since a two-man board in a corporation with three or five shareholders would dilute cumulative voting.

5. Some Technical Points Regarding Director Activities:

(a) Waivers: Statutes, including the Model Act, have routinely provided for notice waivers signed before or after meetings of directors or shareholders. A more recent innovation is the provision that attendance is of itself effective as a waiver of notice as if a document were duly signed. Excepted is the director who attends a meeting solely to make a threshold objection to transacting any business on the ground that the meeting has not been lawfully called or noticed, but it would follow that if his objection were overruled, any participation in the meeting would constitute the statutory waiver of notice.

(b) Consents: After a number of states authorized directors to act without a meeting, the Model Act eventually tagged along. Delaware provides simply that, absent contrary charter restriction, the board or a committee may act without a meeting "if prior to such action a written consent thereto is signed by all members of the board" and "such written consent" is duly filed with the minutes. The Model Act, with some language changes, adopts the same provision. Both are susceptible to two nagging technical difficulties. The implication that all signatures must appear on the same document—witness the singular term "consent" in the statutes—

117 Companies Act, 1948, 11 & 12 Geo. 6, c. 38, §§ 176, 178.
118 More specifically, how strong is the policy favoring cumulative voting? A three-man board in a ten-shareholder corporation would substantially dilute a cumulative voting right, whether granted by statute or charter.
119 ABA-ALI MODEL BUS. CORP. ACT § 137 (1953).
120 E.g., N.Y. BUS. CORP. LAW § 711 (c).
121 § MODEL BUS. CORP. ACT ANN. § 39A (Supp. 1966) (optional provision).
122 DEL. CODE ANN. tit. 8, § 141 (g) (Supp. 1964).
should be eliminated so that separate writings may collectively comprise the "written consent" to informal action. A few statutes now so provide.\textsuperscript{123} Secondly, both the Delaware and Model Act language authorizing consent "prior to" the action taken seemingly negates ratification by signing consents—a needless and probably unintended restriction.

The South Carolina\textsuperscript{124} and North Carolina\textsuperscript{125} statutory provisions are more liberal. Both sanction unanimous written consent and eliminate the "prior to" language, but both still seem to require signing a single document. However, both statutes also authorize informal action by a \textit{majority} if all directors own all shares and all know of and none objects to the action taken, or if all shareholders know and none objects, or if a custom of informal action is known generally to shareholders and all directors know of and none objects to the action taken. These generous provisions chiefly aid close corporations and have less utility for larger enterprises than do the Model Act and Delaware clauses authorizing unanimous written consents.\textsuperscript{126}

\textbf{(c) Director Committees:} While most statutes follow the Model Act,\textsuperscript{127} which permits executive (or other) committees only if the articles or by-laws so provide, it would be preferable to authorize such committees directly if, as, and when desired.\textsuperscript{128} Of course, the usual limits on delegation and responsibility of the full board would remain unaffected, as would any statutory restraints on the powers which could be delegated.\textsuperscript{129} Most statutory provisions for informal director action also apply to committees as well.\textsuperscript{130} Several statutes anticipate that absence or disqualification of one or more members may postpone making a quorum or taking action, and authorize advance designation of alternate members who automatically sit for an absent member.\textsuperscript{131} Finally, two statutes\textsuperscript{132} have authorized the establishment of all types of committees to negate any implica-

\textsuperscript{128} See Del. Code Ann. tit. 8, § 141 (c) (Supp. 1964).
\textsuperscript{129} E.g., 3 Model Bus. Corp. Act Ann. § 38 (1960); N.Y. Bus. Corp. Law § 712.
\textsuperscript{131} E.g., N.Y. Bus. Corp. Law § 712 (b).
tion that only an executive committee may be formed—undoubtedly a groundless fear.

6. Director Vacancies and Removal: Statutes vary widely on handling board vacancies. Many jurisdictions now expressly allow less than a quorum of directors to fill vacancies. Wyoming and Arkansas have valuable provisions for a close corporation which is unfortunate enough to find itself without any directors because of simultaneous death, resignation, or similar contingency and authorize any shareholder or the personal representative of a deceased shareholder to call a meeting to fill the vacancy. Until recently, it was conventional to authorize directors to fill all vacancies other than those resulting from newly created directorships. However, a 1962 Model Act amendment and several recent statutes now permit directors to create new posts and fill them until the next election of directors by the shareholders—a procedure which lends itself to board packing and diminishes the efficacy of minority board representation, albeit temporarily.

There is equally wide variation on removing directors. The new Massachusetts act marks an advance by specifically providing that “a director or officer may be removed for cause only after a reasonable notice and opportunity to be heard before the body proposing to remove him.” Apparently, most statutes take the position that a director elected by cumulative voting may not be removed, either with or without cause, if the votes against removal would be enough to elect him. While this is certainly correct for removal without cause, it is less clear that a director should be immunized from removal for cause simply because he was elected by cumulated votes. No doubt, the fear is that “cause” will be trumped up and rashly adopted by the hostile majority shareholders; but with a statute requiring proof of cause, and assuming that

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123 E.g., N.Y. Bus. Corp. Law § 705 (a).
124 WYO. STAT. ANN. § 17-36.35 (1965); ARK. STAT. ANN. § 64-303 (B) (1966).
125 CONN. GEN. STAT. ANN. § 33-317 (d) (2) (Supp. 1965).
126 § MODEL BUS. CORP. ACT ANN. § 36 (1960, Supp. 1966); ARK. STAT. ANN. § 64-303 (A) (1960); IOWA CODE § 496A.37 (1962); N.Y. BUS. CORP. LAW § 705 (a).
127 ABA-ALI MODEL BUS. CORP. ACT § 36A (1953).
129 E.g., N.Y. BUS. CORP. LAW § 706 (c)(1).
courts will review proven "cause" for adequacy, the director sought to be removed has adequate protection against arbitrary action. No statute has so far dealt with the holding of Essential Enterprises Corp. v. Automatic Steel Prods., Inc.\textsuperscript{141} that a member of a staggered board may not be removed except for cause. New York allows directors to remove a board member for cause if the charter or a shareholder-adopted by-law permits it,\textsuperscript{142} while Massachusetts vests removal power in the directors unless the charter or by-laws provide to the contrary.\textsuperscript{143} Most new statutes adequately protect directors chosen by stock classes,\textsuperscript{144} and New York, always seeking complete coverage, extends this to series within classes and to bondholders entitled to choose directors.\textsuperscript{145}

7. Directors' By-Law Powers: While practical considerations dictate some, perhaps much, director control over by-laws, the difficulties lie in defining the existence and extent of concurrent shareholder powers. The Delaware statute\textsuperscript{148} reposes the power in the shareholders absent delegation to the directors by the certificate of incorporation—a delegation for which the certificate will usually provide. The Model Act\textsuperscript{147} and several very recent statutes\textsuperscript{148} specifically vest by-law power in the directors absent partial or total reservation to the shareholders. The effect on shareholders of delegation, either by charter or by statute, is sufficiently uncertain to make it desirable to clarify the allocation of this power. Judicial authority is wavering and uncertain; while Rogers v. Hill\textsuperscript{149} supposedly recognized continuing concurrent power despite delegation to the directors, the New Jersey statute it involved contained a clause saving shareholder power to amend director-made by-laws.\textsuperscript{150} There is, of course, an ill-defined judicial power to pass on the "reasonableness" of by-laws,\textsuperscript{151} and the SEC proxy rules, as construed in the Trans-

\textsuperscript{141} 29 Del. Ch. 93, 159 A.2d 288 (Ch. 1960).
\textsuperscript{142} N.Y. Bus. Corp. Law § 706 (a).
\textsuperscript{144} E.g., S.C. Code Ann. § 12-18.7 (b) (1) (Supp. 1965).
\textsuperscript{145} N.Y. Bus. Corp. Law § 706 (c) (2).
\textsuperscript{147} ABA-ALI Model Bus. Corp. Act § 25 (1953).
\textsuperscript{149} 289 U.S. 582, 588-89 (1933).
America case,\textsuperscript{152} should afford some sort of a safety-valve for shareholders. An outright statutory grant of by-law power to the directors arguably means total and irrevocable delegation (apart from a charter amendment which would first have to be endorsed by the directors), even more than a statutory clause vesting by-law power in shareholders subject to delegation to directors. The needed safeguard is a clause reserving concurrent power in the shareholders. Several of the recent statutes so provide,\textsuperscript{153} while others go even further in regulating the types of by-laws which directors may make.\textsuperscript{154} In all events, there does seem to be a subtle shift in the direction of consolidating by-law control ever more firmly in exclusive control of the directors.\textsuperscript{155}

8. 

Indemnification of Directors and Officers: During the 1959-1966 period, statutory revisions invariably authorized indemnification of directors and officers, but no marked trends have developed, either to tighten or liberalize corporate practices in this area. For the most part, the alterations have been technical and have reflected a better understanding among draftsmen of this complex field. The statutes have continued to manifest the sharp division of opinion which had emerged much earlier. Most revisions adopted the Model Act provision (as reformulated in 1959) broadly empowering corporations to indemnify directors and officers.\textsuperscript{156} New York\textsuperscript{157} adopted

\textsuperscript{152} SEC v. Transamerica Corp., 163 F.2d 511 (3d Cir. 1947).


\textsuperscript{155} It is an interesting question for speculation as to whether a proposed amendment to by-laws would be a "proper subject" for shareholder action under a Model Act-type statute conferring all by-law powers on the directors with none reserved to the shareholders. Would the Transamerica case have been decided the same way if the law of the jurisdiction so provided? At the other extreme, note the North Carolina provision, apparently unique among American statutes, providing that "any matter relating to the affairs of a corporation is a proper subject for action at an annual meeting of shareholders." N.C. Gen. Stat. § 55-61(d) (1965); see notes 277-81 infra and accompanying text.

a characteristically detailed and thorough regulation which treated
many problems unresolved in earlier statutes. Arkansas\textsuperscript{158} and South
Carolina\textsuperscript{159} followed the older California\textsuperscript{160} and North Carolina\textsuperscript{161}
pattern of placing indemnification wholly or partly under court
control, while Connecticut took an intermediate position.\textsuperscript{162}

(a) \textit{Persons Covered}: Directors and officers, including incumbent
and former personnel, are, as always, the chief beneficiaries of in-
demnification statutes. Several statutes have added personal repre-
sentatives of indemnifiable individuals.\textsuperscript{163} Most statutes have fol-
lowed the Model Act's coverage of executive personnel of subsidiar-
is, although linguistic variations may subject the provisions to
different interpretations. Thus, the Model Act and its progeny refer to directors and officers of another corporation in which the
indemnifying company owns shares or has a creditor interest,\textsuperscript{164}
while Connecticut, New York, and South Carolina simply indemnify
one serving at the "request" of the corporation seeking to award
indemnity.\textsuperscript{165}

Model Act-type statutes which refer only to "directors and offi-
cers" cast doubt on the applicable legal standards for indemnifying
executive personnel who are nevertheless not technically "officers"
under statute, charter, or by-laws. Presumably, common law rules\textsuperscript{166}
would remain in force on the reasonable assumption that the statute
does not pre-empt the entire field. However, statutes have variously
responded to the issue. Thus, Connecticut specifically includes "em-
ployees"\textsuperscript{167} while New York expressly declares that its provisions
"shall [not] affect any rights to indemnification to which corporate
personnel other than directors and officers may be entitled by con-

\textsuperscript{161} Cal. Corp. Code § 830.
§§ 722-25.
\textsuperscript{165} See Model Bus. Corp. Act Ann. § 4 (o) (1960); Del. Code Ann. tit. 8, § 122 (10)
(1953).
\textsuperscript{166} Conn. Gen. Stat. Ann. § 33-320 (d) (Supp. 1965); N.Y. Bus. Corp. Law § 723 (a)
\textsuperscript{167} See Restatement (Second), Agency §§ 438-40 (1956).
tract or otherwise under law." Connecticut follows North Carolina in defining "employee" to include "any person who is engaged to perform services for the corporation, whether as independent contractor or otherwise." Connecticut also includes controlling shareholders within its indemnity provision by defining "officer" to include "any person who has legal power, directly or indirectly, to elect a majority of the board of directors of the corporation."

(b) Indemnifiable Proceedings: It may well be that early statutes were drawn with derivative suits chiefly in mind. At least, some statutes could not readily accommodate desired indemnification of actions by "third parties," that is, "actions or proceedings other than [ones] by or in the right of the corporation." The Model Act and other recent statutes clearly cover third-party civil actions.

However, after Schwartz v. General Aniline & Film Corp. construed the phrase "action, suit or proceeding" in the then New York statute to exclude criminal cases, statutes, including the Model Act, were soon amended to insure this coverage, which became increasingly vital, particularly to executives defending antitrust proceedings. Thus, the Model Act altered its only explicit limitation on a corporation's indemnity power to bar payments to any director or officer who had been "adjudged . . . liable for negligence or misconduct in the performance of his duty to the corporation . . . ." New York, of course, permits indemnity in third-party actions, but its approach is much more refined and precise.

Administrative proceedings are usually construed as falling within the conventional statutory language, although an occasional jurisdiction makes doubly sure by expressly so providing. If the proceedings are purely investigative, it is, however, possible that indemnity might not be allowed, not because an investigation is not a proceeding (it clearly is), but because the statute is keyed to

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171 N.Y. Bus. Corp. Law § 723 (section title).
173 305 N.Y. 396, 113 N.E.2d 553 (1953).
174 The Model Act was revised in 1959.
176 See note 157 supra and accompanying text.
expenses incurred in the "defense" of the action or proceeding. Since the term has at most a Pickwickian meaning in a mere investigation, the statutes purporting to indemnify only expenses of a "defense" may not cover this situation, although at least one court has authorized such indemnity. A similar uncertainty as to the scope of indemnification provisions exists as to expenses incurred in an arbitration proceeding.

Indeed, this difficulty raises the basic question whether indemnification should necessarily be limited to costs of "defense." It may well be appropriate for a director to recover expenses of a suit in which he seeks a declaratory judgment, but the "defense" language could block indemnity. So, too, in complicated litigation involving cross-claims and counterclaims, a court, bound by the "defense" language of the statute, may be in the ridiculous position of allocating legal expense between the director's multiple role as defendant and as counter or cross-claimant. Even if a director should recover the costs of raising his shield, the expenses of aggressively wielding his sword should, as a general rule, be his and not the corporation's. However, statutes might well grant corporations or courts a discretionary power to award indemnification in the occasional situation where action as a plaintiff has demonstrably benefited the corporation as well as the individual.

(c) "Expenses": In practically all recent statutes, indemnifiable "expenses" have been expanded to include attorney's fees. Most statutes, expressly or by implication, and subject to more or less regulation, authorize recovery of judgments, fines (whether on conviction or on nolo contendere pleas), penalties, and amounts paid in settlement of an action. A subtle change is also indicated in the Model Act's switch from its pre-1957 test of "expenses actually and necessarily incurred" to the present test, frequently found in the newer revisions, covering "expenses actually and reasonably" in-
(d) Indemnity Standards and Controls—Third-Party Actions: As indicated, judgments, fines, penalties, and amounts paid in settlements in third-party actions are usually recoverable. The statutes vary in the controls and standards for such recovery.\textsuperscript{183}

Indemnification by Corporation: Prior to 1960, North Carolina had authorized the unsuccessful director to recover if a plan for payment was approved by a majority of voting shares excluding those held by the indemnitee.\textsuperscript{184} California in 1957 abandoned its earlier view requiring court approval of all indemnification and authorized reimbursement upon the directors’ determination “in good faith” that the indemnitee had acted “within what he reasonably believed to be the scope of his employment or authority and for a purpose which he reasonably believed to be in the best interests of the corporation or its shareholders.”\textsuperscript{185} The Model Act continued to employ its loose and vague standard of barring from indemnity only one who was “adjudged . . . liable for negligence or misconduct in the performance of duty to the corporation,” but then it seemingly restored what it had withdrawn by recognizing in the last sentence “any other indemnification” authorized by the articles, by-laws, or resolution of the shareholders “after notice.”\textsuperscript{186} On the one hand, this language arguably supersedes the “adjudged liable” restriction, in which case it is surely improper without some controls; but on the other hand it may only preserve common law rights to indemnity over and above what the Model Act empowers the corporation to make, in which case the provision is poorly drafted.

New York alone distinguishes the divergent issues involved in indemnifying civil and criminal suits and meets the problem of indemnities voting on their own indemnity. For civil actions, re-

\textsuperscript{183} See notes 171-79 and accompanying text supra.
\textsuperscript{185} Cal. Corp. Code § 830 (f).
\textsuperscript{186} Model Bus. Corp. Act Ann. § 4 (c) (1960).
covery may be had by an unsuccessful director or officer who, it is shown, "acted in good faith, for a purpose which he reasonably believed to be in the best interests of the corporation."187 A director or officer criminally convicted must also prove that he "had no reasonable cause to believe that his conduct was unlawful."188 That the statute sharply distinguishes the standards for indemnification from the substantive grounds of the criminal action appears from a further provision that an unfavorable disposition of the case does not of itself preclude the director's meeting the indemnification standards189—a conclusion implicit in the statutory language. Thus, a convicted price fixer might show conduct in the corporation's supposed best interests (indeed, the company may have made a whopping profit during the period of indulgence) but it is doubtful, given present antitrust concepts, that a court would agree that he "had no reasonable cause to believe that his conduct was unlawful."190

Besides these standards, New York imposes certain procedural controls. Complete success on the merits of the action entitles the indemnitee to recover presumably by a simple vote of the directors191 and clearly on a court order.192 Indemnification in other cases requires approval by a disinterested quorum of directors193 or by a vote of the shareholders (apparently without disqualifying interested shares),194 on finding that the statutory standards have been met. The novelty here is that, absent a disinterested director quorum and a desire not to go to the shareholders, the board may indemnify "upon the opinion in writing of independent legal counsel that indemnification is proper in the circumstances because the applicable standard of conduct . . . has been met by such director or officer."195 As against a further public washing of dirty linen incident to convincing shareholders to award indemnity, it would be foolish to suppose that directors will not prefer a private and

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187 N.Y. Bus. Corp. Law § 723 (a).
188 Ibid.
189 N.Y. Bus. Corp. Law § 723 (b).
190 N.Y. Code Ann. § 12-18.18 (b) (1) (B) (Supp. 1965) (Supp. 1965) requires only a court finding that the individual "fairly and equitably merits indemnification."
191 N.Y. Bus. Corp. Law § 724 (a).
192 N.Y. Bus. Corp. Law § 725 (a).
193 N.Y. Bus. Corp. Law § 724 (b) (1).
194 N.Y. Bus. Corp. Law § 724 (b) (2) (B).
195 N.Y. Bus. Corp. Law 724 (b) (2) (A).
discreet opinion of counsel;\(^\text{196}\) and it would be ungenerous to suppose that most counsel will fail to speak impartially.

**Indemnification by Courts:** Since the Model Act provision is solely an “empowering” statute, it recognizes no “rights” to indemnity. At the opposite extreme, South Carolina recognizes a “right” in the sense of judicial discretion to aid even an unsuccessful director or officer who “fairly and equitably merits indemnification.”\(^\text{197}\) New York also authorizes court-ordered indemnity despite a contrary resolution of the directors or shareholders.\(^\text{198}\) This seems sound in the case of a director who may have been ousted after a proxy fight and refused any indemnity for expenses in earlier litigation, no matter how deserving he may have been.\(^\text{199}\)

(e) **Indemnity Standards and Controls—Adjudications in Derivative Actions:** Although indemnification of expenses in third-party, especially governmental, actions poses difficult problems of undercutting public policy—problems not recognized by any of the statutes—indemnity in derivative actions can equally subvert effective enforcement of fiduciary duties. In the extreme case, a director’s recovery of expenses and judgments in a derivative suit which he has lost would deprive the corporation of its adjudicated recovery and entail the added loss of the director’s expenses. Accordingly, the recent statutes continue the established rule, variously stated, that indemnity cannot be granted if the director breached his duty to the corporation.

**Indemnification by Corporation:** Here most of the new revisions follow the Model Act in forbidding indemnification if the director has been “adjudged . . . liable” for breach of duty to the corporation.\(^\text{200}\) Although New York uses the same test,\(^\text{201}\) it regulates cor-

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\(^\text{196}\) However, N.Y. Bus. Corp. Law § 726 (c) in effect requires in such cases that the shareholders be duly and promptly notified as to the “persons paid, the amounts paid, and the nature and status at the time of such payment of the litigation or threatened litigation.”

\(^\text{197}\) S.C. CODE ANN. §§ 12-18.18 (b) (1) (B), (b) (2) (Supp. 1965).

\(^\text{198}\) N.Y. Bus. Corp. Law § 725 (a).

\(^\text{199}\) Occasionally, a corporate by-law will be more restrictive than the statute. See Essential Enterprises Corp. v. Dorsey Corp., 40 Del. Ch. 343, 182 A.2d 647 (Ch. 1962).


\(^\text{201}\) N.Y. Bus. Corp. Law § 722 (a).
porate action in granting permissible indemnity by requiring here, as in the case of indemnity for third-party suits, a disinterested quorum of directors, action by the shareholders, or an opinion of independent counsel. Connecticut also bars indemnity to those "finally adjudged" liable and authorizes indemnity only if the indemnitee has been "successful in his defense on the merits" or if the court has awarded indemnity.

*Indemnification by Courts:* Arkansas follows the earlier California and North Carolina statutes permitting indemnity in derivative actions only on a court finding that the indemnitee was successful in whole or in part in the parent suit, and that his conduct "fairly and equitably merits" the recovery he seeks. South Carolina deletes the first condition so that the court's power to indemnify under a "fair and equitable" standard is measurably broader. New York authorizes judicial award of indemnity, but the court's power is limited by the same standards applicable to the corporation, although it would seem sensible to allow courts a wider discretion in the matter than could properly be entrusted to the corporation.

*Indemnity for Unsuccessful Defendants:* It may be questioned whether indemnification should invariably be withheld from an officer or director who has violated his duty to the corporation. Despite easy statement of the general fiduciary duty, and given the gradual and sometimes unpredictable evolution of sound ethical standards into rules of law, it does not necessarily follow that every director who is "adjudged liable" for breach of duty or who is not "successful in whole or in part" should invariably lose an indemnification right. This would be especially true in some borderline case of conduct which is held for the first time in a particular jurisdiction to constitute a breach of duty. For example, it took some time to reach any definite conclusion on the general contours of a director's right to use corporate funds to buy the corporation's

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202 N.Y. Bus. Corp. Law § 724 (b).
206 S.C. Code Ann. § 12-18.18 (b) (1) (B), (b) (2) (Supp. 1965).
207 N.Y. Bus. Corp. Law § 725.
208 Conn. Gen. Stat. Ann. § 33-320 (c) (Supp. 1965) is broader since success on the merits and a judicial finding that indemnity would be "not reasonable or inequitable" are alternative tests.
own shares to avoid a shift of corporate control; so, too, with the development in Delaware of the law governing stock options.

Clearly, indemnification in such cases is a most delicate matter, and equally clearly it is not something to be left entirely to directors (interested or disinterested) or to shareholders to determine. Yet, as standards of business ethics are translated into rules of law, there may be instances where the risk of loss—especially the risk resulting from a new decision—should rest on the corporation. The British Companies Act so recognizes. Section 448 (1) provides that although an officer of the corporation has been found liable for “negligence, default, breach of duty or breach of trust”—serious wrongs all—the court may nevertheless relieve him in whole or in part from personal liability “on such terms as the court may think fit,” on a finding that the individual “acted honestly and reasonably, and that, having regard to all the circumstances of the case . . . he ought fairly to be excused” from bearing personal liability.209 It is then provided that if the court order relieves any such individual from personal liability, he “shall be indemnified out of the assets of the company.”210 While this poses a rather subtle distinction between honorable and dishonorable, reasonable and unreasonable, breaches of duty, it is not beyond the resources of the courts to make this discrimination.211

The fact that one may not, indeed should not, sympathize with the insider who has cut the line too close is not relevant other than as an outlet for pent-up emotions. Actually, several rational grounds support a role of judicial discretion on this issue, bearing always in mind that such indemnity should never be awarded by corporate act and that if so done the amounts should be recoverable from any one participating in the award. First, a new rule of fiduciary duty can be evolved more readily and declared more boldly if the court can, in an appropriate case, grant indemnity in whole or in part for conduct concededly unethical but not legally wrong at the time,

209 Companies Act, 1948, 11 & 12 Geo. 6, c. 38, § 448 (1).
210 Companies Act, 1948, 11 & 12 Geo. 6, c. 38, § 136. (Emphasis added.)
211 The South Carolina statute after stating a general test for indemnification, authorizes it if “notwithstanding the . . . limitations [stated in the general test], the court finds that the person sued fairly and equitably merits indemnification.” S.C. CODE ANN. § 12-18.18 (b) (1) (B) (Supp. 1965). Thus, it might be wise for the director-defendant to apply for indemnification in the proceeding in which his liability is being adjudicated. The court’s discretion under the South Carolina statute would permit substantially the same results as the English Companies Act.
and thereby avoid a heavy judgment retrospectively imposed upon an individual for the first time. This aids the court caught between the Scylla of holding no breach of duty under existing law, and the Charybdis of exacting a possible crushing personal liability for disregarding an ethical concept which was not then but should now be a legal standard. It is also arguable that the money judgments which usually (though not inevitably) accompany a newly declared duty may be more appropriately borne by the entire enterprise than by the individual who has gone too far, perhaps on legal advice. Again, it is relevant that the risk may be insurable, within limits, under directors’ indemnification insurance policies which are often purchased by corporations. Finally, a mere variation in the factual application of an established rule ought not alone induce a court to award indemnity out of a kindly heart to a “guilty” director. A roughly formulated distinction might be the following: if a court pronounces a new doctrine or concept of duty which cannot reasonably be said to have been anticipated at the time of the acts done by responsible and conservative counsel as a legal rule in contrast to an ethical standard, the cost may in an appropriate case be properly assessed against the corporation. Actual dishonesty, fraud, or wilful misconduct ought, of course, to be excepted. All in all the occasions for meeting these tough problems will probably be few. Although it may sometimes mean that a disreputable insider “gets by,” yet if the way is opened for consolidating higher standards of conduct by inviting what are in effect prospective rules of law, the occasional price is well paid.

(f) Indemnity Standards and Controls—Settlements of Derivative Actions: Although indemnifying expenses in settled as well as adjudicated derivative actions may undercut effective enforcement of fiduciary duties, there is a further policy dimension to indemnification of settlements. Directors should be encouraged to litigate groundless claims against them and thereby vindicate both themselves and the corporation. Indemnification liberally awarded after judicial vindication but withheld after settlement implements that policy. Stated otherwise, indemnification of settled claims not susceptible to a probable successful defense will subvert enforcement of duties. Such indemnification would also encourage strike suits.

since directors might be more willing to compromise at corporate expense, thereby inviting disreputable shareholders to sue and force a costly buy-out. On the other hand, a fixed and immutable rule against indemnification of expenses in all settled actions would contravene the strong policies favoring settlement. For example, judicial power to order indemnity in connection with a court-approved settlement of a derivative action would generally safeguard corporate interests and fairly treat the director or officer who has secured a favorable settlement, but indemnity in these situations should be allowable only if the court approves it.

The Model Act and its progeny apparently allow indemnity in connection with any settled derivative suit, whether or not approved by a court. This conclusion follows from the fact that the "adjudged liable" limitation does not apply to a settlement, and also from the draftsmen's somewhat dubious view that the term "expenses" includes the amount of a settlement. The Model Act approach would be to allow indemnity for any amount "actually and reasonably incurred" in settling the action, subject neither to court or statutorily required intracorporate controls nor to disclosure requirements.

Fortunately, other states have adopted an approach less tainted by an obviously excessive deference to management self-interest. Arkansas, like the pre-1959 California and North Carolina statutes, authorizes court-ordered indemnity of settlement "expenses" on showing (1) that the suit was settled with court approval or that the indemnitee was "successful in whole or in part . . . in any settlement" of the action against him and (2) that his conduct "fairly and equitably" merits indemnity. Since the statutes refer to "expenses of defense," it is unclear whether the settlement sum itself

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213 Indeed, it would be "unhealthy" to "place a director in the position where he would be assured of indemnification if he settled but would run the risk of paying his own attorney if he unsuccessfully risked the action." Essential Enterprises Corp. v. Dorsey Corp., 40 Del. Ch. 343, 351, 182 A.2d 647, 652 (Ch. 1962).

214 3 MODEL BUS. CORP. ACT § 4(o) (1960).

215 The second clause of the Model Act provision authorizes indemnity by shareholder-adopted by-law or resolution "after notice." 3 MODEL BUS. CORP. ACT ANN. § 4(o) (1960).

216 CAL. CORP. CODE § 830 (a) (1).


is indemnifiable. South Carolina adopts the California formulation but prescribes that the indemnity may include the settlement sum as well as the expenses of the action. Since all three would exclude settlements not approved by the court, presumably payments could be recovered from the indemnitee and from those who indemnified him contrary to the terms of the statute. The New York statute apparently bars any indemnity for the settlement sum, even if the settlement has court approval, and permits indemnity of expenses only if the settlement has court approval. Thus, New York appears to adopt the most restrictive test of all for indemnity in connection with settled derivative actions.

(g) Miscellaneous Provisions on Indemnification: Only a few points remain to be noted. New York properly bars indemnity for "expenses incurred in defending" and "amounts paid in settling or otherwise disposing of a threatened action," thereby eliminating the incentive for a director to buy out a strike (or other) suit knowing or expecting to be repaid. An advance, or at least a novelty, is another New York provision authorizing indemnity of expenses before final judgment, subject to approval by a disinterested board, the shareholders, or an opinion of independent counsel; but the indemnitee must repay any amounts advanced to which he is ultimately found not to be entitled.

Several statutes have dealt with the exclusiveness of the statutory indemnity provisions. The Model Act, of course, leaves the matter wholly uncertain, first by empowering the corporation to indemnify except when the indemnitee has been "adjudged liable" for breach of duty, and then by sweepingly authorizing "any other indemnification" recognized by the articles, or by any shareholder-adopted by-law, or resolution, without, however, repeating the "adjudged liable" standard. In short, it is vaguely all-inclusive, not to mention wretchedly drafted. New York, the Carolinas, and California all make their statutes exclusive. Connecticut, while not explicit,
seemingly pre-empts the field.\textsuperscript{227} Certainly, it is better to adopt a fair and comprehensive statute proscribing indemnification inconsistent with its terms, than to open the door for types of indemnity which may violate sound policy. The ease with which secret under-the-table deals can slip by even the strictest laws is sufficiently great that statutes should not be written so as to facilitate their nefarious objectives.

III. SHAREHOLDERS: MEETINGS AND VOTING

The post-1959 statutes have generally developed only a few unusual provisions on shareholder meetings and voting, adhering in the main to the Model Act pattern with some modifications and added detail. Since the subject matter is well known, this part of the article culls out only a few of the noteworthy provisions for discussion, consciously risking a distorted picture by concentrating on distinctive and odd features.

1. Quorum: It is, of course, commonplace for statutes to authorize greater-than-majority quorum and vote requirements at shareholder meetings, chiefly to serve the peculiar needs of close corporations. While quorums may usually be fixed as high as desired, they are customarily limited on the down-side by the Model Act requirement of a minimum of one-third of the shares entitled to vote at the meeting.\textsuperscript{228} A few statutes bar any such reduced proportion\textsuperscript{229} on the theory that since a majority of the votes usually controls action at shareholder meetings, a minimum quorum of one-third means that crucial shareholder action may be taken by as little as one-sixth of the shares entitled to vote (or perhaps less if all shares present do not vote). The most surprising provision is Iowa's explicit authorization of any proportion less than a majority of the shares entitled to vote at the meeting.\textsuperscript{230} An unofficial comment indicates that the Iowa corporation law revision committee specifically intended for the articles to define the quorum in any way the incorporators wished, however small it might be. The proffered

\textsuperscript{228} ABA-ALI Model Bus. Corp. Act § 30 (1953). In the absence of a reduced percentage provided for by the articles of incorporation, the Model Act requires a majority of the shares entitled to vote. \textit{Ibid.}
\textsuperscript{229} E.g., S.C. Code Ann. § 12-16.8 (a) (Supp. 1965).
\textsuperscript{230} Iowa Code § 496A.31 (1962).
defense of this strange provision is that since some local corporations have "several hundred or even several thousand shareholders with a limitation that no one may own more than one share," even a one-third quorum would "make it difficult or impossible for some of these corporations ever to hold a meeting."\(^{231}\) Assuming *arguendo* that this is accurate as to some corporations, such as rural telephone companies, the obvious solution is to stipulate a special quorum rule for such enterprises, as at least two other states have done.\(^{232}\) Instead, the Iowa statute authorizes any corporation, whatever its size or its number or distribution of shareholders and whether or not its special needs demand unique rules, to adopt a dangerous charter provision. Any layman can readily see that a corporation dominated by, say, a twenty per cent block of stock, need only fix a twenty per cent shareholder quorum and thereafter, with the aid of some other statutory provisions, need never fear God, man, or the courts.\(^{233}\)

2. *Vote Required:* Another remarkable provision is Iowa's deviation from the conventional but sound rule that at a meeting at which a quorum is present, a majority of shares—whether stated as a majority of votes cast,\(^{234}\) or of the shares represented at the meeting,\(^{235}\)—will be decisive.\(^{236}\) Most states authorize a greater-than-majority rule, but, with the exception of Iowa, none seems to have embraced the view that, "whenever . . . the articles of incorporation require the vote or concurrence of the holders of a . . . lesser proportion of the shares, or of any class of series thereof, than required

\(^{231}\) Comment, IOWA CODE ANN. § 469A.31, at 301 (1962).

\(^{232}\) CAL. CORP. CODE § 2211 (twenty per cent of the shareholders is a quorum for mutual water company); Mo. ANN. STAT. § 351.267 (1) (Supp. 1965) (for rural telephone companies, five per cent of shares is a quorum); WYO. STAT. ANN. § 17-36.29 (1965) (ten per cent shareholder quorum for corporations with more than 100 shareholders none of whom has more than one vote).

\(^{233}\) Regrettably some other statutes, while not so blatant as Iowa, are vague on reducing a statutory quorum of a majority. Usually, this comes from stating the majority quorum rule along with a phrase "unless otherwise provided . . . ." WYO. STAT. ANN. § 17-36.29 (1965). Arguably, then, any percentage will do if the articles so state. However, since this statute is simply the Model Act language with the final clause preserving a minimum quorum of one-third, it looks rather as if the draftsmen wished to authorize super-statutory quorums ("unless otherwise provided") but bar less-than-statutory quorums. For an explicit provision, see S.C. CODE ANN. § 12-16.8 (a) (Supp. 1965).

\(^{234}\) E.g., N.Y. BUS. CORP. LAW § 614 (b).

\(^{235}\) E.g., CONN. GEN. STAT. ANN. § 33-329 (b) (1960).

\(^{236}\) A few states, influenced by New York, more precisely specify a plurality rule for electing directors. N.Y. BUS. CORP. LAW § 614 (a); D.C. CODE ANN. § 29-915 (d) (1961); S.C. CODE ANN. § 12-16.10 (a) (2) (Supp. 1965).
by this Act with respect to such action, the provisions of the articles of incorporation shall control."237 Since no down-side limits are stated, nothing in the statute precludes a corporation from taking corporate action with a minority of votes cast. One can play a fascinating game of making out various combinations and permutations with the low quorum and the low vote provisions of this statute. And, indeed, the game has even more interesting possibilities when one mixes in two additional ingredients: (1) that a controlled corporation may vote shares which it owns in a controlling corporation, if its articles so permit,238 and (2) that "nothing in this chapter shall prohibit a corporation in its articles of incorporation from limiting or denying the right to vote by proxy."239 Coupled with a provision initially inserted in the articles of incorporation requiring a relatively high vote to amend out one or more such provisions already included in the articles, shareholders can be legally disfranchised. Entrepreneurs need no longer look to other more "liberal" American jurisdictions, or to Panama or Curacao, for incorporation provisions guaranteeing maximum "flexibility"—that idol before which some corporate lawyers and some corporate-law draftsmen do deep obeisance.

3. Informal Action and Written Consents: The more recent revisions and amendments exhibit a cautious trend towards allowing non-unanimous shareholder action without a meeting, thus moving away from the hitherto accepted view that such "informal" action must be taken by all of the shareholders. New York first states the conventional requirement and then validates a certificate of incorporation, otherwise consistent with law, authorizing "the written consent of the holders of less than all outstanding shares" to take action.240 By its very nature, such a provision is useful only for a corporation with a manageable number of shareholders. The pun is intentional. Besides small enterprises, it will be available to corporations where a large block of stock is owned or controlled, directly or indirectly, by a few inside, management personnel who can act informally as they wish.

The New York provision seemingly leaves unsolved certain matters as to disclosure and notice. After all, statutory notice to share-

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238 \textit{Iowa Code} § 496A.32 (1962) (second paragraph).
239 \textit{Iowa Code} § 496A.32 (1962) (last paragraph).
240 \textit{N.Y. Bus. Corp. Law} § 615 (a).
holders is given only for a "meeting," but these procedures are alternatives to "meetings." Unanimous action implies that each shareholder in some sense knows of the action since by hypothesis he has signed the consent. Less-than-unanimous action without a meeting lacks this intrinsic safeguard. Non-unanimous action, though impeccably conforming to the authorized charter clause, may invite courts to take an exceptionally close look, particularly if some shareholders are ignorant of the action taken. To avoid such risks, insiders would do well to notify all shareholders in advance of the action proposed to be taken in this fashion. Better still, any statute authorizing such action should specifically require that notice, either before or after the action is taken, be given to all shareholders who would be entitled to vote on the matter if a meeting had been called and the matter submitted to them. In either case, shareholders could still act informally by less than a unanimous vote, but it would be fairer and more prudent to give notice and thereby reduce the risk of judicial hostility, particularly if the transaction involves "interested" persons.

Besides New York, Nevada permits less-than-unanimous shareholder action without a meeting. California, however, limits such action to approving a merger by "written consent of the holders of not less than two-thirds" of the shares entitled to vote on the merger.

4. Persons Entitled to Vote: Like the Model Act, recent revisions go into considerable detail as to voting by fiduciaries of various types. Several jurisdictions, unlike the Model Act, have special rules for shares with multiple owners, for example, joint and common tenants, whether or not they are fiduciaries. As earlier noted, Iowa contributes a provision by which the articles of A Corporation may permit stock owned by B Corporation in A Corporation to be voted at A’s meeting even though A owns a

241 N.Y. BUS. CORP. LAW § 605 (a).
242 It is perhaps possible to deduce such a requirement from the complex interplay of N.Y. BUS. CORP. LAW §§ 602 (a), 605 (a).
244 Cal. Corp. Code § 4107.
245 ABA-ALI MODEL BUS. CORP. ACT § 31 (1953).
246 N.Y. BUS. CORP. LAW §§ 609 (d)-(f) (pledgors and pledgees), 625 (infants).
248 See notes 238-39 supra and accompanying text.
majority of the shares in B. Thus, A could turn over a block of A stock to B, a subsidiary (or otherwise controlled corporation), and B would be able to vote these shares at A's annual meeting—presumably on instructions from A. Of course, such shares may be so voted "if, but only if, the articles so provide . . . ." Arguably, this safeguard may not be wholly adequate to prevent abuse.

While Iowa thus swallows a camel, several jurisdictions strain at the gnat of a corporation voting its own shares which it holds in a fiduciary capacity. Although such concern is not misplaced, it is questionable whether the probable danger justifies the burdensome restrictions placed by some states on such fiduciaries. While Wisconsin and Oklahoma broadly permit voting of fiduciary-owned shares, and Kentucky has reached the same result by judicial reading of its statutes, Virginia requires a second, independent fiduciary, and North Carolina requires a court to appoint an "independent and disinterested trustee" on a showing of a "necessity" for his voting the shares. Usually, the number of corporations holding their own stock as trustees is small, and frequently the number of shares so owned is a small proportion, although occasional situations have arisen where a corporation's fiduciary-owned shares might be decisive in voting. However, it seems fair to assume that the corporate fiduciary acting through its trust officers will hesitate to vote the shares so as to favor the corporation at the expense of the beneficiary's interests; for if this happened, there would be a breach of duty both to beneficiary and to shareholders. It seems questionable to single out for special restriction the voting of fiduciary-owned shares. Rather, the cause for concern,

249 The exact wording of Iowa Code § 496A.32 (1962) is that "neither treasury shares nor, unless the articles of incorporation otherwise provide, shares held by another corporation if a majority of the shares entitled to vote for the election of directors of such other corporation is held by the corporation, shall be voted at any meeting or counted in determining the total number of outstanding shares at any given time."


255 In Graves v. Security Trust Co., 369 S.W.2d 114 (Ky. 1963), the twenty-four per cent block of bank stock held in a fiduciary capacity by the bank was decisive in approving a merger. It is reported that Cleveland Trust Co. holds thirty-three per cent of its own shares in fiduciary accounts. Wall Street Journal, Jan. 21, 1965, p. 2, col. 3.
if any, should be not the rare opportunity to misuse voting power, but the chance that the corporate fiduciary will hold its own shares in trust at a time when an independent trustee would sell the shares. If, however, a restriction is in order, it would seem best simply to create an independent co-trustee, or perhaps two co-trustees who would then have a majority vote.

5. Cumulative Voting: Corporation laws continue the old split on permissive versus mandatory cumulative voting, despite some tendency of the recent revisions to make it permissive unless blocked by constitutional provisions. Technical developments include provisions requiring advance notice from a shareholder intending to cumulate his votes so as not to catch off-guard other shareholders who have perhaps fallen into the habit of voting straight during an era of good feeling, and provisions affording a brief recess of the meeting to allow the parties to calculate the most effective cumulation of their votes. Whether cumulative voting is mandatory or permissive, an occasional statute protects it by forbidding a director's removal if the votes against such action would be sufficient to elect him or by prohibiting a reduction in the number of directors under substantially the same test.

6. Protecting High Quorum and Vote Requirements: Several jurisdictions recognize that high-vote requirements embodied in the charter or shareholder-adopted by-laws may possibly be amended out by the normal statutory majority or two-thirds vote. Even if the charter forbade amendment except by the high vote, it might be possible to amend out that provision and then remove the high-vote clause. Hopefully, courts would see realities and protect the high-vote requirement in both instances rather than allow a carefully wrought bargain to be subverted. However, no one can confidently predict such a result, especially if the high-vote requirement had produced a deadlock which threatened corporate profits or existence. Several recent statutes deal with the issue. South Carolina specifically protects high votes on amendment, merger, and sale of assets. Connecticut does better with a single clause applicable

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266 See 2 Scott, Trusts § 170.15, at 1233 (2d ed. 1956).
268 N.Y. Bus. Corp. Law § 706 (c) (1).
to every high vote specified in the articles of incorporation.\(^2\) New York allows a high vote to be added or removed by a two-thirds vote of all shares or by a greater than two-thirds vote if the certificate requires such a greater vote for this specific purpose.\(^2\) Thus, in New York, complete protection for a unanimous voting requirement ultimately comes from a charter provision that only a unanimous vote may remove or modify this provision, thereby putting the burden on the certificate draftsmen to think out the degree of protection desired. Moreover, the high-vote requirement must be conspicuously noted on the stock certificate.\(^2\)

7. Proxy Voting: As in the past, state statutes authorize proxy voting but provide only tangential, if any, regulation or control. Probably, all statutes recognize proxy voting in the Model Act sense that “a shareholder may vote . . . by proxy . . . ,”\(^2\) without declaring that a shareholder is entitled to vote by proxy. Perhaps statutes should confer on shareholders a right to a proxy vote in case articles of incorporation or by-laws might purport to deprive them of this only feasible means, in many corporations, of participating in its affairs,\(^2\) however little the opportunity may be valued by shareholders. While proxies have usually been solicited with minimal mandatory disclosure of the proposed action or relevant

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\(^2\) N.Y. Bus. Corp. Law § 616 (b).

\(^2\) N.Y. Bus. Corp. Law § 616 (c). New York, incidentally, is the only state which gives such protection to a superstatutory quorum requirement; other jurisdictions do so only for a high vote provision. It is questionable whether a high quorum, with its possibilities of forcing deadlock merely by absence from meetings, merits the same protection as a high-vote requirement, which at least compels the dissenter to appear, talk, listen, and fight for his interests if only as a Neinsager.

\(^2\) Two older American statutes appear to guarantee a right to vote by proxy. See Idaho Code Ann. § 30-134 (3) (1948); La. Rev. Stat. § 12:32 (c) (1951). Both the English and the Northern Ireland Companies Act specifically provide that “any member of a company entitled to attend and vote at a meeting of the company shall be entitled to appoint another person [whether a member or not] as his proxy to attend and vote instead of himself . . . .” Companies Act, 1948, 11 & 12 Geo. 6, c. 38, § 136 (1); Companies Act, 1960, 9 Eliz. 2, c. 22, § 130 (1) (No. Ireland). Both statutes require the notice of meeting to declare this statutory right of proxy voting. Since a close corporation may want its shareholders to vote in person, a close corporation statute could appropriately permit such a charter clause even though a statute grants a right of proxy voting. The English and Northern Ireland statutes have no such exception, but Northern Ireland does provide that only a shareholder of a private company may act as proxy for another shareholder of the same company. Companies Act, 1960, 9 Eliz. 2, c. 22, § 130 (2) (b) (ii) (No. Ireland).
the Iowa statute leaves room for management effectively to deprive the shareholders of their votes by demanding that votes be cast, if at all, in person, perhaps at a "meeting" at the president's hunting lodge in upper Canada.\footnote{266} It would require a dedicated, if not courageous, "corporate democrat" to appear in person in such circumstances, particularly if, as is likely, he would encounter a permitted charter clause barring a shareholder resolution not previously noticed by the directors for action at the meeting.\footnote{268} It does not, however, require a convinced exponent of the theory of shareholder democracy to discern the unfairness of such statutory and charter provisions, either singly or in combination.

Not unlike the earlier proxy statutes, the recent enactments allow varying periods of duration for a proxy, with Massachusetts prescribing possibly the shortest life by invalidating a proxy dated six months before the meeting for which it is given and terminating its effectiveness after the meeting's final adjournment.\footnote{269} Various states go beyond the Model Act provision\footnote{270} and enumerate kinds of writings which constitute valid proxies.\footnote{271} The newer revisions often protect the corporation from automatic revocation by death, supervening incapacity, or a shareholder's unheralded appearance in person at the meeting, by requiring written notice directed to an appropriate officer before the power given by the proxy is exer-


\footnotetext[268]{Like ABA-ALI MODEL BUS. CORP. ACT § 26 (1953), IOWA CODE § 496A.27 (1962) authorizes shareholder meetings “at such place, either within or without this state,” as provided by the articles or by-laws or fixed in accordance with their provisions.}

\footnotetext[271]{ABA-ALI MODEL BUS. CORP. ACT § 26 (1953). “A shareholder may vote either in person or by proxy executed in writing by the shareholder or by his duly authorized attorney in fact. No proxy shall be valid after eleven months from the date of its execution, unless otherwise provided in the proxy.”}

\footnotetext[269]{IOWA CODE § 496A.26 (1) (1962) (five per cent of voting shares may compel noticing a proposed amendment to the articles “unless otherwise provided in the articles of incorporation . . . .”).}


cised.\textsuperscript{272} South Carolina, in addition, requires proxies to be dated as of their execution, barring undated or postdated instruments.\textsuperscript{273} On the state level, useful results hopefully will follow from the South Carolina provision,\textsuperscript{274} inspired by SEC Proxy Rule 14a-9,\textsuperscript{275} forbidding solicitation of any proxy "on the basis of any proxy statement, form of proxy, notice of meeting, or other communication, written or oral" employing a misleading statement or omission. Although this provision is not supported by the prophylaxis of administrative supervision, court enforcement at the instance of an aggrieved shareholder should deter at least some grosser forms of misconduct.\textsuperscript{276}

Several state statutes contain provisions relevant to the "proper subject" concept of SEC Proxy Rule 14a-8.\textsuperscript{277} Almost unknown is North Carolina's declaration that "any matter relating to the affairs of a corporation is a proper subject for action at an annual meeting of shareholders . . . ."\textsuperscript{278} The SEC proxy rules clearly do not view every shareholder proposal as a "proper subject" and bar a proposal which "is, under the laws of the issuer's domicile, not a proper subject for action by security holders."\textsuperscript{279} Since state statutes seldom address themselves to the allocation of powers between shareholders and management (beyond specifying acts which require shareholder approval), the SEC's task of applying this standard has not been an easy one. Perhaps the resort to "advisory" proposals has been a convenient (and, all things considered, desirable) way out.\textsuperscript{280} The North Carolina provision surely must go beyond even the fondest dreams of the SEC staff. Literally, it obliterates the distinctions usually observed by the SEC and would allow shareholders to present resolutions on matters such as financial policy, labor relations, dividends, sales policy, racial questions, advertising, and other "affairs" normally deemed exclusive management prerogatives not to

\textsuperscript{275}17 C.F.R. § 240.14a-9 (1964). The statutory provision closely tracks the typical SEC "anti-fraud" language.
\textsuperscript{276}Although it would have been well for the statute specifically to grant courts jurisdiction to grant all needed relief, it is assumed that enforcement will be available since, otherwise, the statute is merely hortatory and a counsel of ethics.
\textsuperscript{277}17 C.F.R. § 240.14a-8 (1964).
\textsuperscript{279}SEC Proxy Rule 14a-8 (c) (I), 17 C.F.R. § 240.14a-8 (c) (1) (1964).
\textsuperscript{280}On advisory proposals, see 2 Loss, Securities Regulation 908-11 (1961).
be invaded even by "advisory" proposals. How far the SEC will go in relation to North Carolina shareholder proposals is uncertain, although it may choose to continue its own rules of self-restraint even when state law makes almost anything a "proper subject."  

A different problem is presented by statutes which arguably confine shareholder interests, as a matter of state law, exclusively to those matters on which they have specific authority to vote. The Model Act formulation 282 is too vague to mean much in terms of intracorporate allocation of powers and thus probably offers little help in culling proper from improper subjects. The Massachusetts statute, presumably not specifically intended to meet this problem, takes a stronger tack by stating that "the directors may exercise all the powers of the corporation" (rather than merely manage its "business and affairs") "except such as by law, by the articles of organization or by the by-laws of the corporation are conferred upon or reserved to the stockholders." 283 This language can be read as a distribution, granted or permitted by state law, of specified powers to the shareholders with the directors having all residual power and authority. If so, the SEC could be forced into polarized positions on the scope of "proper subject" depending upon whether a shareholder proposes a resolution to a North Carolina or a Massachusetts corporation. Indeed, the focus of the problem will likely shift in the future. It is probable that eventually the Model Act and various states will draft language, probably stronger than Massachusetts', to negate, so far as state law can, the "propriety" of subjects for shareholder action. 284 If state law does attempt in the

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281 Compare SEC Proxy Rule 14a-8 (c) (5), 17 C.F.R. 240.14a-8 (c) (5) (1964), providing that management need not include a shareholder proposal if it "consists of a recommendation or request that the management take action with respect to a matter relating to the conduct of the ordinary business operations of the issuer."

282 "The business and affairs of a corporation shall be managed by a board of directors." ABA-ALI MODEL BUS. CORP. ACT § 33 (1953).

283 MASS. GEN. LAWS ANN. ch. 156B, § 54 (Supp. 1965); see also MASS. GEN. LAWS ANN. ch. 156B, § 47 (Supp. 1965).

284 An analogy is the Model Act's provision, widely adopted, that "nothing in this Act contained shall be construed to authorize [the adopting] . . . State to regulate the organization or the internal affairs . . ." of a foreign corporation seeking to do business locally. ABA-ALI MODEL BUS. CORP. ACT § 99 (1955). Most new revisions include this language, although Texas abjured regulation of a foreign corporation's "internal affairs not intrastate in Texas," TEX. BUS. CORP. ACT ANN. art. 8.01 (A) (1956). South Carolina altogether deleted this clause. S.C. CODE ANN. § 12-23.1 (a) (Supp. 1965). New York adopts certain types of internal regulation for foreign corporations doing business in New York. N.Y. BUS. CORP. ACT §§ 1315-20. The Model Act provision was designed to dissuade any jurisdiction from seeking
future to limit shareholder interests at meetings, the SEC may well be forced to reconsider whether it should formulate this question of federal law in state law terms or whether it should treat the content of shareholder proposals by a uniform national standard in the interests of effective shareholder participation through the proxy process.

IV. SHAREHOLDER CONTROL DEVICES

1. Voting Trusts: The old view that voting trusts improperly segregate the vote from beneficial ownership has been abandoned by validating provisions in all of the recent revisions and amendments. Statutes usually limit the trust life to ten years, but several recent enactments authorize extensions of the trust for an additional ten-year period. New York has permitted the trust to be extended for more than one additional ten-year period, but of course, only shareholders who are parties to the extended trust are affected thereby. These statutes contain a minor ambiguity as to whether the new trust runs from the expiration date of the old trust or from the date when the extension is made, although presumably good draftsmanship would stipulate the former. South Carolina prevents invalidation of an entire trust merely because its duration might exceed the statutory ten-year period, but also provides that...
the trust becomes "inoperative" thereafter.\textsuperscript{290} Ohio interestingly preserves common law voting trusts from pre-emption by the statutory voting trust which is limited to ten years.\textsuperscript{291}

Occasional statutes spell out a few rights of certificate holders. Thus, North and South Carolina reserve the right of beneficiaries under the voting trust to vote on fundamental corporate changes.\textsuperscript{292} A few statutes give certificate holders rights to inspect corporate books\textsuperscript{293} or to institute derivative actions.\textsuperscript{294} Other states have one or more unique provisions.\textsuperscript{295}

2. Irrevocable Proxies: The statutes of New York,\textsuperscript{296} Connecticut,\textsuperscript{297} and South Carolina\textsuperscript{298} contain provisions specifically authorizing various types of irrevocable proxies, the most important of which is the irrevocable proxy annexed to a shareholders' voting agreement. Each statute spells out slightly different provisions for duration of the proxy, and all three protect the innocent purchaser of shares subject to an irrevocable proxy unless the existence of the proxy is conspicuously noted on the stock certificate.

3. Voting Agreements: Several recent revisions and amendments have specifically authorized shareholder voting agreements. This is desirable, not so much because of old fears of invalidity, but because voting trust statutes might be read, as they were in Delaware, to pre-empt the field and bar voting agreements (especially those with enforcement provisions) among shareholders.\textsuperscript{299} This result should be avoided since no sound policy reason requires forcing all

\begin{itemize}
    \item \textsuperscript{290} S.C. Code Ann. § 12-16.16 (f) (Supp. 1965).
    \item \textsuperscript{291} Ohio Rev. Code Ann. § 1701.49 (f) (Page 1964).
    \item \textsuperscript{292} N.C. Gen. Stat. § 55-72 (c) (1965) (mandatory); S.C. Code Ann. § 12-16.16 (g) (Supp. 1965) (may be varied by voting trust agreement).
    \item \textsuperscript{293} E.g., N.Y. Bus. Corp. Law §§ 621 (c), 624 (b).
    \item \textsuperscript{295} E.g., N.Y. Bus. Corp. Law §§ 609 (f)-(g).
    \item \textsuperscript{296} N.Y. Rev. Stat. § 271.325 (5) (1962).
    \item \textsuperscript{298} See Abercrombie v. Davies, 36 Del. Ch. 571, 180 A.2d 338 (Sup. Ct. 1957).
\end{itemize}
shareholder control devices into the somewhat formalistic mold of a voting trust. Accordingly, voting agreements are specifically authorized in New York, Connecticut, South Carolina, Texas, and Wyoming. Connecticut, South Carolina, and Texas limit the agreement to ten years, thereby securing parity with voting trusts, and all three provide for extensions. Connecticut and Texas require filing with the corporation subject to shareholder inspection rights and also protect subsequent purchasers of shares subject to the agreement by requiring a conspicuous notation on the stock certificates. Thus, in Connecticut and Texas, the agreement looks more like a formal voting trust, while in New York, South Carolina, and Wyoming it is closer to the common law voting pool. Wyoming has made a particularly valuable addition in this area by providing:

In an action by a shareholder who is a party to such an agreement a court of competent jurisdiction may enjoin another party or parties to such agreement from voting his or their shares in violation thereof, and the court may, in an action to which the corporation is a party, by appropriate decree set aside an election of directors or other action resulting from the voting of shares in violation of such agreement, and in addition the court may grant such other or further relief as is appropriate under the circumstances for the enforcement of such agreement.

Texas and South Carolina also authorize enforcement of the agreement, but without the comprehensive grant of jurisdiction found in Wyoming. In all three states, at the very least, such statutes are declaratory of a favorable legislative attitude which should discour-

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Notes:

300 N.Y. Bus. Corp. Law § 620 (a).
305 Professor Bradley suggests that the ten-year limitation on the life of voting agreements under the South Carolina statute is “a reactionary requirement” inconsistent with the “close corporation concept of freedom and flexibility” which he generously says that statute embraced. Bradley, Toward a More Perfect Close Corporation—The Need for More and Improved Legislation, 54 Geo. L.J. 1145, 1173 (1966). However, the ease with which such agreements (and voting trusts) may be extended, in South Carolina and in the other states, answers that contention. Policy considerations also call for parity as to duration of the several kinds of permissible control devices, and for reopening the control arrangements after a reasonable time for changes, adjustments, or admission or resignation of parties to the particular arrangement.
307 Statutes cited notes 302-03 supra.
age courts from narrow construction and niggardly enforcement of shareholder agreements.

V. Other Shareholder Rights and Interests

1. Minutes and Records of Corporations: Apart from the generally adopted Model Act provisions requiring keeping corporate records and authorizing inspection by qualified shareholders, the variations among the states are not surprising. Thus, among the new revisions, a statute may delete the statutory requirement of keeping books and records, reduce or eliminate the Model Act’s qualifications for shareholder inspection, or eliminate or change the procedures and penalties when a corporation refuses to permit inspection. An occasional statute gives shareholders additional rights to compel certain information.

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208 ABA-ALI Model Bus. Corp. Act § 46 (1953). This statute authorizes inspection only by one who has been a shareholder of record for at least six months before his demand or who holds of record at least five per cent of “all outstanding shares of a corporation.”


210 There are numerous variations here. Some states have no holding or percentage qualifications. Conn. Gen. Stat. Ann. § 33-334 (b) (1960); Utah Code Ann. § 16-10-47 (1962). Mississippi requires only a one per cent stockholding. Miss. Code Ann. § 5309-111 (Supp. 1964), and New York and South Carolina measure the five per cent holding, not against “all the outstanding shares” as in the Model Act, but against “the outstanding shares of any class” and also permit aggregations of holdings to make up the statutorily required percentage. N.Y. Bus. Corp. Law § 624 (b); S.C. Code Ann. § 12-16.26 (a) (2) (Supp. 1965).

211 The Model Act has an awkward procedure by which if a corporation refuses inspection, the complaining shareholder may sue for a small statutory penalty, and the corporation may then defend on various grounds. Sometimes, this is deleted. E.g., Neb. Rev. Stat. § 21-2050 (Supp. 1965). New York has a much better procedure by which the corporation has limited discretion to deny access to a shareholder who refuses to furnish an affidavit as to proper purpose and no past sales of shareholder lists. On denial, the shareholder must initiate a court suit to procure the desired records. N.Y. Bus. Corp. Law §§ 624 (c)-(d).

212 Under ABA-ALI Model Bus. Corp. Act § 46 (1953), the corporation must honor a shareholder’s written request for a copy of its most recent balance sheet and profit-and-loss statement. Under D.C. Code Ann. § 29-920 (d) (1961), a five per cent shareholder may demand that the corporation prepare and file within thirty days a “particular account of its assets and liabilities in detail,” which any shareholder may thereafter inspect and copy.

On the other hand, an occasional statute will sharply curtail, at least for certain corporations, a pre-existing broad statutory right of inspection. Thus, the North Carolina statute which entitles qualified shareholders to inspect as of right the “books and records of account,” N.C. Gen. Stat. § 55-38 (b) (1965), was amended in 1965 to exclude, in the case of banks, any of “the deposit records or loan records of a bank customer”; these are available only on court order granted “for good cause shown.” N.C. Gen. Stat. § 55-38 (i) (Supp. 1965). This small indicator that banking “regulation” favors bank management and depositors over bank shareholders was a swift legislative reaction to a decision construing “books and records,” subject
Perhaps the most interesting innovations are the statutes specifically declaring, in New York's language, that various books and records are "prima facie evidence of the facts stated therein in favor of the plaintiff" in suits against the corporation or its directors, officers or shareholders.\(^3\) Connecticut more generally makes such documents "prima facie evidence of the facts stated therein" only if "certified to be true" by the corporation's secretary. It also declares that when referred to in such documents, meetings are deemed duly held and called, motions and resolutions duly adopted, and director elections and officer appointments deemed valid, until invalidity is proved, presumably by the person challenging the statements. Finally, "whenever a person has acted in good faith in reliance upon any such certified original or copy, it is conclusive in his favor." While much the same result would presumably be reached without statute, it is good to see such provisions codified.\(^8\)

California and New York also explicitly recognize the use of data retrieval systems. New York authorizes all books and records of account, minutes, and shareholder records to be kept in any non-written form, if "capable of being converted into written form within a reasonable time."\(^3\) California, while specifying various permissible methods of storing information, only extends the statutory permission to the stockholder records.\(^31\)

Voting lists for shareholder meetings are becoming harder to obtain. In 1964, the Model Act deleted its earlier provisions requiring the corporation to prepare and keep on file for ten days before the meeting a shareholder list for any shareholder to inspect. Now the list is available only at the meeting.\(^31\) The effect of the

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\(^8\) There are potentially significant differences in the books and records subject to inspection under the New York, Connecticut, and South Carolina statutes. New York includes books and records of account, minutes of shareholder proceedings, director and committee meetings, and shareholder lists. N.Y. Bus. Corp. Law §§ 624 (a), (g). The other two states refer to minutes of the proceedings of incorporators, shareholders, directors, and committees; and also add written consents, waivers, etc., and any statements "that no specified proceeding was had or that no specified consent, waiver, release or agreement exists . . . ." Conn. Gen. Stat. Ann. § 33-416 (1960); S.C. Code Ann. § 12-24.9 (Supp. 1965). Connecticut and South Carolina, therefore, do not include shareholder records or financial records and books.

\(^31\) N.Y. Bus. Corp. Law § 624 (a).

\(^31\) Cal. Corp. Code § 3002.

change is that information formerly available through a voting list must be obtained under the shareholder-inspection provisions, subject to the percentage or time-of-holding restrictions. South Dakota and Wisconsin have followed the change, while Virginia retains the old provision but in the case of a listed corporation requires shareholders to establish percentage or time-of-holding qualifications.

2. Shareholder Derivative Actions: Since the most significant developments continue to occur in judicial decisions, only a few statutory provisions seem significant. To the extent that the new revisions follow the Model Act, they normally make important changes, often by deleting the Model Act’s security-for-expenses provisions or by allowing the court to unload on plaintiff all reasonable expenses of all defendants on a finding that the suit lacked “reasonable cause.” Often retained is a statutory rule of contemporaneous ownership of shares (or, in a few instances, voting trust certificates) necessary to qualify a shareholder as plaintiff. Somewhat unusual is the Pennsylvania provision giving the court discretion to waive the contemporaneous ownership requirement on showing “a strong prima facie case in favor of the claim asserted on behalf of the corporation and that without such suit serious injustice will result.”

In line with cases relaxing old and highly ambiguous case law requirements of a “demand on shareholders” are statutes in several states specifically requiring a demand on directors (or explanation of a failure to do so) but not mentioning recourse to the shareholders. A Delaware Chancery Court rule is more explicit and abolishes the requirement. In at least three states, an instituted

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319 Wis. STAT. ANN. § 180.29 (1) (Supp. 1966).
322 E.g., N.Y. Bus. CORP. LAw §§ 626 (a), (b); Wis. STAT. ANN. § 180.405 (1) (a) (1957).
325 Cal. CORP. CODE § 834 (a) (2); N.Y. Bus. CORP. LAW § 626 (c); Ohio REV. CODE ANN. § 2307.311 (Page Supp. 1965); Wis. STAT. ANN. § 180.405 (1) (b) (1957).
326 The requirement of a demand on directors was deleted in DEL. CH. CR. R. 23 (b), as amended April 27, 1961. This amendment does not appear in the 1964 supplement to DEL. CODE ANN. See letter from the Hon. Collins J. Seitz, former Chancellor of the State of Delaware, to John Gallagher, member, Delaware Code Revision Commission, June 24, 1965.
action may be discontinued, compromised, or settled only with the consent of the court. The deficiency is that the buy-off of a threatened action seems to be outside the statutory scheme. The need is, of course, for judicial recognition of a broad principle that any funds received by a shareholder, whether in compromise of an instituted or a threatened suit, are held by the shareholder as a constructive trustee for the corporation, or better still, for statutory language so providing. Unfortunately, where several statutes quite properly declare that amounts received in a judgment, compromise, or settlement of a derivative action inure to the corporation, the legislation seems limited only to the suit which has been instituted.

VI. FUNDAMENTAL CORPORATE CHANGES

Recent statutory enactments have consistently dealt separately with certain procedural prerequisites for corporate action amounting to a fundamental change in the structure or identity of the corporation. Under the familiar title of “fundamental corporate changes,” this discussion briefly reviews provisions in the recent statutes concerning amendments to the articles of incorporation, mergers, sales and other dispositions of assets, dissolution, statutory efforts to meet the de facto merger problem, and shareholder appraisal rights.

1. Amending Articles of Incorporation: The law in this area has remained relatively static, and, so far as the new and amended statutes have touched it, the changes are chiefly technical. All revisions grant sweeping power to amend. The vote required for amendment varies from a majority to two-thirds of the shares entitled to vote on the amendment. Class voting is ordinarily preserved with a few states expressly authorizing voting by series if one or more but less than all series within a class are affected. Occasionally a recent statute excuses from any shareholder vote certain minor matters which per accidens take the form of an amendment of the

articles, for example, the location of the corporation's registered office or the identity or address of its registered agent. Similarly, exceptions to required shareholder approval will be made for amendments prior to the organizational meeting or before shares are issued. State variation on the procedure for restating the articles of incorporation may range from the Model Act's pre-1962 needless requirement of a two-thirds shareholder vote for every restatement to the more reasonable provision permitting directors to restate absent further amendments or changes, in which event shareholder approval is necessary and proper.

Apart from class voting, little statutory protection is available for minority voting or for non-voting shares. States which did not previously authorize dissenters' rights on amendment have not embraced that remedy despite the enlarged amendment powers vested in the shareholders. Nebraska's 1963 revision retained its judicial procedure enabling any shareholder "adversely affected" by a proposed amendment "changing the existing priority rights or provisions of any class of shares outstanding" to secure court relief against such an amendment for "fraud or unfairness." The court must enjoin the amendment unless management or other proponents prove it to be "fair, just and equitable to all shareholders affected thereby." A better wrought procedure is provided by the English Companies Act and duplicated in other jurisdictions influenced by that statute. The salient provisions of the English law, along with the Jenkins Committee recommendations, are that fifteen per cent

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335 Ore. Rev. Stat. § 57.360 (2) (1963) (amendment by directors; subscriber may rescind within thirty days, after which subscriber is bound).
340 Ibid.
341 Companies Act, 1948, c. 38, 11 & 12 Geo. 6, § 72.
of the shareholders of the affected class may petition the court to vacate a “variation of the rights” voted by the majority. The court has discretion to so vacate on a finding that the change would “unfairly prejudice the shareholders of the class” affected, but otherwise it “shall . . . confirm the variation.” Speedy action is guaranteed by a requirement that the petition must be filed within twenty-one days of the resolution. The Jenkins Committee found widespread support for this procedure and recommended reducing the statutory percentage from fifteen to ten per cent; extending the time for filing the petition; and removing the requirement in the present statute that all shares comprising the fifteen per cent block petitioning for relief must have voted against the “variation.” Apart from the potential difficulty of putting together such a block in so little time, the Jenkins Committee found that the existing requirement barred a nominee holding shares of record for beneficial owners who were split on the question of approval from petitioning for relief on behalf of the dissenting beneficial owners. This is the same problem which induced several American statutes to authorize a record owner of shares, such as a broker, to dissent and seek appraisal rights for beneficial owners opposed to some corporate action, while voting for the action on behalf of other owners. Even the existing English statute, which would certainly be improved if all Jenkins Committee recommendations were enacted, is an improvement over the Nebraska statute both in requiring some substantial number of shareholders to set aside the amendment and in articulating the appropriate procedure to do so.

Initiating the amendment process normally remains exclusively with the directors, who need not notice a shareholder’s proposed amendment. Apparently, only a few new revisions authorize a stated percentage of shareholders to compel voting on an amendment, and these revisions echo earlier procedures.

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844 See notes 377, 382, 391, 398-400 infra and accompanying text.
845 Iowa Code § 496A.56 (l) (1962) (five per cent or more of shares entitled to vote; may be abolished by charter); S.C. CODE ANN. § 12-19-A (d) (Supp. 1965) (ten per cent of any class of shares); Utah Code Ann. § 16-10-55 (b) (1962) (notice must state that amendment is proposed by shareholders; management may recommend acceptance or rejection); Wyo. Stat. Ann. § 17-36.52 (a) (1965) (ten per cent of any class of shares). England and Northern Ireland provide that if five per cent of the shareholders propose a resolution of a kind which “may properly be moved and is intended to be moved” at the meeting, management must circulate both the resolution and a statement of more than 1000 words, if the documents are received in due time together.
2. Corporate Fusions: All of the new and amended statutes, with the important exception of Ohio, adhere to the traditional and formalistic distinction between merger and consolidation, sale of assets, and (to the limited extent statutes deal with it) purchase and sale of controlling shares. Although business and finance choose one or the other of these fusion methods for good economic and tax reasons, the choice is, unfortunately, needlessly shaped by different substantive consequences of the procedure chosen, including different voting requirements and shareholder appraisal rights. Besides the irrational statutory differences, several courts further confuse the matter by hanging a sword of Damocles in the form of an asset sale or share acquisition upon transactions constituting a merger "in reality." Critically needed is a complete rethinking of this entire area in favor of a single flexible procedure or, better still, the shearing of the differential consequences of traditional methods.

(a) Merger and Consolidation: Here, two moderately significant changes have emerged in the new statutes. First, the required shareholder vote for a merger or consolidation has typically been reduced. Prior to 1962, the Model Act and many states required a two-thirds vote of all outstanding shares whether or not entitled to vote, although there was great variation among the states on what shares and how many could vote. In 1962, the Model Act was amended to require only a two-thirds vote of shares entitled to vote on the matter, which means, of course, that usually only common will vote. Thus, preferred stock continues to lose protective rights or journeys more and more to the bondholder end of the spectrum, depending upon one's view of such developments. A few states permit the statutory two-thirds to drop to a majority or, under the Iowa dispensation, even below a majority. A curiosity in this area is Oklahoma's enactment of a statute, supplementing its merger and asset sale provisions, authorizing "reorganizations" in language very similar to INT. REV. CODE OF 1954, § 368(a)(1). OKLA. STAT. ANN. tit. 18, § 1.170a (Supp. 1965). Several states have adopted the new language. E.g., WIS. STAT. ANN. § 180.64 (Supp. 1966).

A ABA-ALI MODEL Bus. CORP. ACt § 67 (1955).  
A OHIO REV. CODE ANN. § 1701.79 (B) (Page 1964).  
continues to be guaranteed when any class would be entitled to vote. Virginia drops the normal two-thirds class vote, where applicable, to a majority if the SEC "exercises jurisdiction over the proxy statement" for the meeting called to consider the amendment. Thus, in Virginia an amendment may be approved for a corporation listed on an exchange or registered with the SEC by a two-thirds vote of all shares and a majority vote of any affected class. Presumably, the Virginia theory is that SEC-supervised disclosure so assures a knowledgeable vote by a shareholder class that its protection is a legitimate substitute for the higher class vote. Incidentally, shares disfranchised under the new Model Act provisions are still entitled to notice of the proposed action and apparently to an appraisal right.

Secondly, the most recent statutes liberalize permissible types of consideration used in a merger. The Model Act permits "shares or other securities or obligations" of the surviving corporation, but several states authorize "shares, bonds or other securities" of the surviving or new corporation or "cash or other consideration to be paid or delivered in exchange for shares of each constituent corporation, or a combination thereof." The use of cash or other securities to buy out minority interests and thus preclude a continuing equity interest, was first recognized in short-form mergers of subsidiaries into parent corporations. The reason for the more

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3 E.g., 3 MODEL BUS. CORP. ACT ANN. § 67 (1960, Supp. 1966); N.Y. BUS. CORP. LAW § 903 (a)(2).
353 3 MODEL BUS. CORP. ACT ANN. § 73 (1960).
354 ABA-ALI MODEL BUS. CORP. ACT §§ 65 (c), 66 (c) (1953).
355 E.g., N.Y. BUS. CORP LAW § 902 (a)(3).

Most new statutory revisions routinely adopt the Model Act provision authorizing short-form mergers between parent and subsidiaries, although varying as to the required percentage of shares owned by the parent, ranging from 90%, DEL. CODE ANN. tit. 8, § 253 (a) (Supp. 1964); TENN. CODE ANN. § 48-518 (1964), to 95%, e.g., N.Y. BUS. CORP. LAW § 905 (a), to 100%, e.g., CONN. GEN. STAT. ANN. § 33-370 (1960). It was announced recently that American Telephone and Telegraph Co. had decided to merge Western Electric Company into itself under the New York statute, making a cash payment to the 650 minority shareholders who own the outstanding 0.15% stock interest other than AT&T's 99.85%. Wall Street Journal, Sept. 14, 1966,
restrictive older rule in the case of ordinary mergers or consolidations is not clear, but presumably it was the fear that unwanted interests would be forced from participation in the new or surviving enterprise. However, by authorizing, as statutes normally do, the use of "securities or obligations" in the new or surviving corporation, a class of shareholders may be expelled as equity owners. If they no longer have the equity owners' opportunity of unlimited capital growth, it matters little whether cash or bonds or other "securities or obligation" work their ouster. Moreover, while use of cash will vitiate certain otherwise tax-free reorganizations under the Internal Revenue Code, the use of cash in a merger or consolidation, if authorized by state statute, does not entail a taxable event under the Internal Revenue Code, except to the extent of the cash or other boot.\footnote{13}{\int . \text{REV. CODE OF 1954, § 368 (a) (1)(A), contains no express provision barring use of "boot" in a statutory merger or consolidation, in contrast to the requirement that a sale of assets is a tax-free reorganization only if the acquisition is "in exchange solely for all or part of [the acquiring corporation's] ... voting stock," Int. Rev. Code of 1954, § 368 (a) (1)(C). However, limitations upon the use of cash or other "boot" in a statutory merger or consolidation inhere in the judicial "continuity of interest" doctrines.}

Finally, the new and amended statutes adopt other provisions, most of them new to the particular jurisdiction, which authorize parent-subsidiary mergers, abandonment of the transaction or postponed effectiveness, carry-over of earned surplus from constituent into the new or surviving corporation,\footnote{20}{\text{ABA-ALI MODEL BUS. CORP. ACT § 71 (Supp. 1965); Ark. Stat. Ann. 64-801 (1966). See also N.Y. Bus. Corp. Law § 911.}} and, under the Ohio statute, certain mergers without a vote of the shareholders of the surviving corporation.\footnote{35}{\text{See, e.g., 3 MODEL BUS. CORP. ACT ANN. §§ 2 (1), 19 (1960, Supp. 1966); N.Y. Bus. Corp. Law § 517 (a) (1)(B). These statutes permit carryovers in mergers, consolidations, or other corporate combinations via asset or stock acquisitions.}}

(b) Transfer of Assets: No significant developments concerning sale of assets appear in the new statutes, other than the increasingly frequent provision dispensing with a shareholder vote for a mortgage, pledge, or other security interest in corporate assets. This has been long recognized in many states, and after the Model Act so amended its provisions, several states followed suit.\footnote{30}{\text{Ohio Rev. Code Ann. § 1701.79 (A) (Page 1964).}} In line with its merger section, the Model Act requires a two-thirds vote of
voting shares to approve an asset sale out of the normal course of business, as do other statutes though with the usual variations. Unlike its merger provisions, the Model Act allows “money or property” as well as shares as consideration for assets, thereby creating another artificial difference between mergers and asset sales. A few states have adopted the now standard clause for abandoning an asset sale. New York and one or two other states specify that the conventional test for requiring a shareholder vote, whether an asset sale is in or out of the course of regular business, refers to the business “actually conducted” by the corporation, rather than the business authorized by the charter whether or not actually conducted at the time. Availability of dissenters’ appraisal rights continues to vary among the new revisions and amendments. Thus, de facto merger problems remain whether the jurisdiction, besides appraisal rights for mergers, denies such rights altogether in a sale of assets or grants them to the shareholders of the selling corporation. Both Pennsylvania and Ohio have attempted to deal with this problem.

(c) Acquisition of Shares: The least regulated area of fusions is what the English call a “take-over bid” through one corporation’s acquisition, attempted or consummated, of a controlling block of shares in another corporation. The groundwork for such acquisitions is the generally conferred statutory power to acquire the shares of other corporations. However, no American statutes (Ohio aside) have any provisions for a right to vote by shareholders of the acquiring corporation on a proposed stock acquisition. Some incidental controls exist if the acquiring corporation does not have a supply of unissued shares and must secure newly authorized shares to effect the stock acquisition, but this is no help if the corporation does not disclose its intended use of the new shares or does so in vague and general terms. Furthermore, the use of cash for such a purpose is wholly within the discretion of the acquiring corporation’s directors. Whatever form of consideration is used, and however great the changes effected by the transaction, shareholders have no voting rights or dissenters’ rights. Here, as with a sale of assets, the de

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4 N.Y. Bus. Corp. Law § 909(a).
5 See notes 390-91, 396-400 infra and accompanying text.
facto merger doctrine may be judicially applied, but its application is infrequent and unsettling.

An important English statute relevant to stock acquisitions provokes surprisingly little American interest despite the flurry of such transactions in the United States. Under Companies Act section 209, a corporation inviting tenders of another corporation’s shares may, after acquiring rights to ninety per cent of the sought shares, compel the non-assenting minority to sell their shares at the offering price.365 The minority shareholders have a corresponding right to force the acquiring corporation to take in their shares.366 The statute does not apply to offers for less than all of the outstanding shares of the company (or a class of such shares)367 or to offers made at different terms to different shareholders.368 The ninety per cent test is figured only against the shares held by disinterested owners, thereby excluding those held or controlled by the acquiring corporation.369 Either the minority shareholder or the acquiring corporation may obtain court enforcement against the other.

The theory of the English statute is that, absent the acquiring corporation’s power of compulsory acquisition, a minority could block the majority by refusing to accept the offer, and that in all events a potentially annoying minority interest would remain outstanding. The procedure is defended as a device which would encourage a fair and equal price to all parties, rather than permit exchange purchases and private deals at varying prices with some sellers doing better than others.

A statute of this type may well have a useful role if we view mergers, asset sales, and majority share acquisitions as three different means of achieving the same end and as therefore deserving parity so far as fair and practical. Under existing statutes, a definite percentage of shareholders of the constituent companies in a merger and of the selling corporation in an asset sale consolidation may bind dissenters subject only to the latter’s cash appraisal rights. In these two situations, the surviving or the purchasing corporation

365 Companies Act, 1948, 11 & 12 Geo. 6, c. 38, § 209 (1).
366 Companies Act, 1948, 11 & 12 Geo. 6, c. 38, § 209 (2) (b).
367 Companies Act, 1948, 11 & 12 Geo. 6, c. 38, § 209 (1). Actually, it is not certain that statutory remedy is available only for offers for all shares, as the Jenkins Committee noted in urging that the statute be clarified. Company Law Committee, Report, Cmd. No. 1749, at 105 (1962).
368 Companies Act, 1948, 11 & 12 Geo. 6, c. 38, § 209 (1) (a).
369 Companies Act, 1948, 11 & 12 Geo. 6, c. 38, § 209 (1).
achieves full control of the other corporation or its assets, with minorities handled by appraisal proceedings. Also, under recent statutes, shareholders may be excluded from a "continuity of interest" in the fused enterprises by the simple expedient of using bonds or cash for purchasing assets or effecting a merger. Whether or not this policy is a good one, it is increasingly authorized. The issue thus is whether, in a share acquisition, the results of a majority decision (in this case, the decision of a majority of the selling shareholders) should bind all in favor of the acquiring corporation. This is no more an expropriation than occurs in mergers and asset sales, especially when the selling corporation distributes the consideration received by it to its shareholders in dissolution.

Assuming that such a statute fits into a rational scheme of laws for corporate fusions, the English prototype insufficiently protects a dissenting minority. First, the statute possibly applies to an offer for less than all shares, so that the acquiring corporation can force its will on ten per cent of the shares it seeks—a point which the Jenkins Committee would correct. Secondly, while the statute allows court action by either the shareholders (to force buyout) or the acquiring corporation (to compel sellout), no standard of value has been developed, other than the terms accepted by the majority of the shares. This assumes that because many have accepted, the price must be fair—an argument echoing the attitude of some courts towards forcing a minority of preferred shares to accept a scale-down of their dividend arrearages. Thirdly, since judicial power to revise or vary an offer's terms discriminates against those who accepted an offering price different from the court's, a statute should empower the court to require a uniform price for all shares, treating alike those initially acquired and those forcibly sold at the court-approved price.

(d) Statutes and the De Facto Merger Problem: The most advanced developments in the corporate fusion area are the product of judicial application of the de facto merger doctrine. Because of the disparity between relatively strict statutory rules governing mergers and the more lenient provisions applicable to sales of assets and because of the almost total absence of regulation of fusions via

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870 See note 367 supra.
871 Companies Code 1961, §§ 234-35 (Ghana) does incorporate most of these changes, which are also consistent with Jenkins Committee recommendations. Company Law Committee, Report, CMD. No. 1749, at 105-10 (1962).
buying and selling controlling share interests, corporate lawyers understandably prefer the more "flexible" procedures. Some courts have treated this as morally reprehensible and have therefore applied to asset sales or share acquisitions the tough merger requirements. The number of cases is few but they are significant in their total impact. They are a threat to the certainty businessmen and corporate lawyers supposedly venerate, since (1) most states have not passed on the question either pro or con, and (2) those states which have adopted or hinted at the de facto merger doctrine have developed no criteria making its application vel non readily or even remotely predictable in a given fact situation. Only those states which have firmly rejected the application of merger rules to asset sales or share acquisitions have achieved any certainty; but this has simply meant that in such jurisdictions, the stricter merger rules with their presumed protection for shareholder interests may be evaded by recourse to asset sales or share acquisitions with or without a dissolution of the acquired corporation or the subsidiary, however much the transaction functionally and operationally resembles a merger.

This is not the occasion to debate the wisdom of either position. This briefly sketched picture is background for the several statutes which, with varying degrees of foresight and effectiveness, respond to the de facto merger problem, which can no longer be ignored. Statutes of four states will be examined.

**North Carolina:** North Carolina's pioneer statute was the first to deal with the problem. And it is a problem under the North Carolina statute, which in most cases requires for merger a majority vote of all outstanding shares (voting and non-voting) of all corporations participating in the merger and grants appraisal rights to all dissenters. However, the statute requires a two-thirds vote of all shares (voting and non-voting) for a sale of assets. As usual in these statutes, it does not regulate the acts of the purchasing

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374 N.C. GEN. STAT. § 55-108(b) (1965). A majority class vote is guaranteed in appropriate circumstances.

375 N.C. GEN. STAT. § 55-113 (b) (1965).

376 N.C. GEN. STAT. § 55-112 (c) (b) (1965).
corporation, nor is there anything regulating sale and purchase of controlling shares. Thus, the disparity of regulation could invite \textit{de facto} merger contentions in an appropriate case, although an asset sale is somewhat less attractive because of the state's reverse twist of requiring a higher shareholder vote to sell assets than to merge.\footnote{The reverse is presently true in Delaware. \textit{Compare} \textit{Del. Code Ann.} tit. 8, \S\ 251 (c) (Supp. 1964) ("two-thirds of the total number of shares of its capital stock" to approve a merger) \textit{with} \textit{Del. Code Ann.} tit. 8, \S\ 271 (Supp. 1964) ("majority of the stock issued and outstanding having voting power" required for sale of assets).}

The North Carolina statute does offer a neat solution to at least one problem. While retaining the two-thirds vote for sale of assets for shares of another corporation, it gives dissenters' appraisal rights to the shareholders of the corporation selling its assets "for, or substantially for, shares of another corporation, foreign or domestic."\footnote{\textit{N.C. Gen. Stat.} \S S 55-113 (a) (1), (b) (1965). Presumably, the term "shares" as used here includes both voting and non-voting shares. The North Carolina statute recognizes no appraisal rights if assets are sold for consideration other than "shares."} However, this single provision hardly reduces the disparity among fusion techniques which invites judicial intervention. For one thing, under such a statute, a court could still hold that the sale of assets for shares was "really" a merger and that the transaction should be set aside since there was no vote by or dissenters' appraisal rights for shareholders of the purchasing corporation. Secondly, since the statute in no wise benefits shareholders of either the acquiring or acquired corporation when the transaction takes the form of a majority stock acquisition, the way is still open for \textit{de facto} merger doctrines. The risk is enhanced since, arguably in the case of an asset sale for shares, the court might well hold preemptive the apparent legislative policy of allowing fusion through this method with only the seller's shareholders having voting and dissenters' rights.

\textit{Connecticut:} The Connecticut approach is inspired by North Carolina's but develops along different lines. The basic pattern is that a merger requires a two-thirds vote of all shareholders (voting and non-voting),\footnote{\textit{Conn. Gen. Stat. Ann.} \S 33-366 (b) (1960).} and dissenters in participating corporations have appraisal rights with one crucial exception.\footnote{\textit{Conn. Gen. Stat. Ann.} \S 33-373 (c) (1960) (dissenting shareholder of surviving corporation has appraisal rights only if merger effects amendment of certificate of incorporation).} A sale of assets re-
quires a like two-thirds vote of all shareholders. Thus, Connecticut eliminates a disparity which exists in the North Carolina statute as to the required vote. It also refines the North Carolina rule that if assets are sold "primarily" for "securities" of another corporation and if "such transaction is part of a general plan of liquidation and distribution essentially equivalent to a merger," then any special vote provisions applicable to mergers shall apply to the sale of assets for securities; any of the selling corporation's shareholders dissenting from this kind of transaction have appraisal rights. The Connecticut provision is an "improvement" over North Carolina if one feels that certainty is gained by distinguishing between asset sales for securities which are, and those which are not, "part of a general plan . . . essentially equivalent to a merger." In practice, however, the comprehensive North Carolina rule is more certain and easier to administer. Moreover, Connecticut, like North Carolina, leaves unresolved the question of voting and appraisal rights of the shareholders of the purchasing corporation; so that again a de facto merger problem exists if a court is convinced that the transaction is one calling for protection of the purchasing corporation's shareholders.

While Connecticut, like North Carolina, recognizes no voting or appraisal rights for shareholders of the purchasing corporation, de facto merger possibilities, clearly present in the North Carolina scheme, are avoided by additional Connecticut provisions achieving a considerable parity of procedure between mergers and sales of assets. First, the merger statute dispenses with any vote of the shareholders of the surviving corporation under specified circumstances and withdraws appraisal rights, thus reducing the incentive to invoke the de facto merger doctrine. Secondly, at the other end of the scale, the requirement that the shareholders of a corporation selling its assets under a "general plan . . . essentially equivalent to a merger" shall possess the same voting and dissenters' rights as the shareholders of a merging corporation achieves parity simply.

\[\begin{align*}
\text{CONN. GEN. STAT. ANN.} & \text{§ 33-372 (d) (Supp. 1965).} \\
\text{CONN. GEN. STAT. ANN.} & \text{§ 33-372 (e) (Supp. 1965). There is also a cross-relation between this section and \text{CONN. GEN. STAT. ANN.} \text{§ 33-366 (b) (i) (ii) (1960).}} \\
\text{CONN. GEN. STAT. ANN.} & \text{§ 33-373 (1960).} \\
\text{CONN. GEN. STAT. ANN.} & \text{§ 33-366 (b) (2) (1960).} \\
\text{CONN. GEN. STAT. ANN.} & \text{§ 33-373 (c) (1960).}
\end{align*}\]
by absorbing the judicial de facto merger rule into the statute itself.\textsuperscript{385}

Thus, with qualifications, it can be said that Connecticut marks an advance if parity is the prime test of progress in this area. Yet, it does leave untouched a possible application of the de facto merger doctrine to a purchase and sale of controlling shares followed by a merger-like absorption of the now controlled subsidiary.

Pennsylvania: Pennsylvania's handling of the de facto merger issue was a direct response to \textit{Farris v. Glen Alden Corp.},\textsuperscript{386} in which the court held an ostensible sale of corporate assets for shares of the purchaser to be in substance a merger, and proceeded to set aside the transaction for failure to comply with the merger statutes giving the appraisal right to dissenting shareholders.\textsuperscript{387} The 1959 amendments to the Pennsylvania statute granted appraisal rights to dissenting shareholders of a purchasing corporation if the acquisition involved the purchaser's issuing fifty per cent or more of the voting shares outstanding after the acquisition;\textsuperscript{388} but a 1963 amendment changed the test to whether the newly issued voting shares could elect a majority of the directors of the issuing corporation.\textsuperscript{389}

As an \textit{ad hoc} response, the Pennsylvania statute leaves unresolved at least as many problems as the North Carolina statute. The 1959 and 1963 amendments deal only with appraisal rights. Thus, while shareholders of each merging corporation and shareholders of a selling corporation act by a majority of voting shares,\textsuperscript{390} and dissenters have appraisal rights,\textsuperscript{391} the statute does not recognize voting rights for shareholders of the purchasing corporation even if a control block of its shares are issued in the acquisition. To that extent, then, openings remain for the de facto merger doctrine. Moreover, none of the Pennsylvania amendments deals at all with majority

\begin{footnotes}
\item[385] CONN. GEN. STAT. ANN. §§ 33-372 (c) (Supp. 1965), 373 (d) (1960).
\item[387] Alternatively, the court held that the sale of assets was an "upside-down" transaction in which the nominal purchaser was the real seller, and vice versa. On this basis, the court was able alternatively to justify awarding appraisal rights to the shareholders of the nominal purchaser by treating it as the real seller and applying the Pennsylvania statute granting appraisal rights to shareholders of the selling corporation.
\item[388] Pa. Laws 1959, No. 1406, § 1.
\item[389] PA. STAT. ANN. tit. 15, §§ 2852-311 (F) -908 (C) (Supp. 1966).
\item[390] PA. STAT. ANN. tit. 15, §§ 2852-311 (B) (Supp. 1966) (vote on assets sale), -902 (C) (Supp. 1966) (vote on merger).
\end{footnotes}
stock acquisitions, either to give a vote or dissenters' rights to shareholders of the acquiring corporation. Again, lack of parity leaves interstices for judicial intervention.

Ohio: Ohio alone has undertaken to treat all three methods of corporate fusion as different means to the same end and, regardless of the method chosen, to give to shareholders of the acquiring corporation the same protection which hitherto has been available only for shareholders of the surviving corporation in a merger. The policies of parity and shareholder protection are well, although not completely, served.

The three traditional methods are (1) merger or consolidation; (2) "majority share acquisition," defined as the acquisition by an Ohio corporation or its subsidiary of a majority of shares of another corporation, in exchange for voting shares of the Ohio corporation; and (3) "combination," defined as a transaction (other than a merger or consolidation) involving an Ohio corporation's acquisition of all or substantially all assets of another corporation, in exchange for voting shares of the Ohio corporation or of the foreign parent corporation of an Ohio subsidiary which receives the assets.

For such transactions, the following rules—stated without their exceptions and limitations—are fashioned. The basic test is whether or not one-sixth or more of the voting shares are issued by the acquiring corporation in a "combination" or "majority share acquisition" or by the surviving corporation in a merger. If in any of these three instances, fewer than one-sixth of the voting shares are issued, then the transaction need not be approved by the shareholders of the acquiring corporation (in a combination or majority share acquisition) or of the surviving corporation (in a merger), and the shareholders of these corporations have no dissenters' appraisal rights. Conversely, if one-sixth or more of the voting

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393 Ohio Rev. Code Ann. § 1701.01 (R) (Page 1964). The phrase "majority of shares" is my own and is used in lieu of the precise but lengthy statutory language, "shares of a corporation, 'domestic or foreign,' entitling the holder thereof to exercise a majority of the voting power in the election of directors of such corporation . . . ."


396 Ohio Rev. Code Ann. § 1701.79 (A) (2) (Page 1964). In the case of a merger, excusing a shareholder vote is contingent on meeting six other conditions as well as the quantum of voting shares issued. These conditions preserve unchanged the internal organization and basic documents of the surviving corporation.

shares are issued in any one of the three transactions, the shareholders of the acquiring or surviving corporation have the right to vote by a two-thirds vote, and dissenters have appraisal rights. It should be stressed that this test applies only to the shareholders of the acquiring or surviving corporation. Thus, in a merger, shareholders of all constituent corporations other than the survivor are entitled to voting and appraisal rights; and shareholders of the selling corporation have like voting and appraisal rights. Voting rights are defined throughout as two-thirds of the voting shareholders, thereby eliminating different results depending upon the choice of method of fusion.

The Ohio statute certainly does the best job to date of dealing with the de facto merger problem. It eliminates the major source of trouble by giving complete parity to shareholders of the acquiring or surviving corporations, both as to vote and dissenters’ rights. For the transactions with which it deals, it is certainly completely pre-emptive of any interstitial common law innovations along de facto merger lines. Thorough as it is, the situations with which it does not deal should be pointed out. First, it does not include acquisitions of all or substantially all assets of another corporation or of a majority block of shares of another corporation, if the consideration is cash, creditor securities, preferred stock, property, or, in general, anything other than the issuer’s voting shares. But if the transaction took the form of a statutory merger under statutes allowing almost any kind of consideration to be used, voting and dissenters’ rights would arise. To that extent, then, different consequences

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397 OHIO REV. CODE ANN. §§ 1701.79(B) (Page 1964) (voting rights on merger), .84(A)(2) (Page Supp. 1965) (voting rights on combination or majority share acquisition). In each case, the two-thirds vote may be reduced by the articles of incorporation to a majority.

398 OHIO REV. CODE ANN. §§ 1701.81(B) (Page Supp. 1965) (appraisal rights on merger), .84(D) (Page Supp. 1965) (appraisal right on combination or on majority share acquisition).

399 OHIO REV. CODE ANN. §§ 1707.76 (A)(2) (Page 1964) (two-thirds or majority if articles permit), .76(C) (Page 1964) (appraisal rights). It should be noted that appraisal rights, where applicable in either a merger or sale of assets, run to the shareholders of all classes entitled to receive notice of the meeting, whether or not entitled to vote.

400 OHIO REV. CODE ANN. §§ 1701.01(Q), (R) (Page 1964).

401 This results from the definitions of “combination” and “majority share acquisition” which both refer to the consideration as voting shares, either of the corporation or a parent. OHIO REV. CODE ANN. §§ 1701.78(B)(10) (Page 1964) broadly specifies permissible types of consideration which may pass in a merger.
could ensue. If the statute's theory is the elimination of every possible occasion for a court to sneak in the *de facto* merger doctrine, of course, it fails here, although realistically the courts are not very likely to be much worried by a transaction using other than voting shares. If, as is more likely, the statute's theory is to give shareholders a voice in connection with a major dilution of their equity interest, then its policy is not offended even if the transaction smells like a merger in all respects save the use of voting shares. Related to this is Professor Herwitz's point that the Ohio statute does not cover a transaction in which a corporation sells a more-than-one-sixth block of voting shares for cash which it then uses to acquire assets or stock of another corporation, although a direct issue of the voting shares would come under the statute.\footnote{Herwitz, Materials on the Planning of Corporate Transactions 723 (1966).}

If the anti-dilution theory of the statute is accurate, then this subterfuge transaction is offensive to its policy; but many other considerations come into play before one can approve an automatic extension of the statutory coverage to the situation Herwitz posits.\footnote{Herwitz, op. cit. supra note 403, does not argue that the statute should cover the situation he poses, but that to do so presents "some pretty testing questions in this area."}

Again, the Ohio statute does not apply, even though the acquiring corporation issues one-sixth or more of its voting shares, if the transaction involves an acquisition of less than a majority of the shares of another corporation or less than "all or substantially all" assets of another corporation.\footnote{Again, this follows from restrictions in the definitions in Ohio Rev. Code Ann. §§ 1701.01 (Q), (R) (Page 1964).} Applying the anti-dilution theory of the statute, it is clearly inadequate in its coverage, since the equity owner's interest is just as much diluted if all or less than all assets are purchased or if fifty per cent or twenty per cent of the shares of another corporation are acquired.

Finally, the statute does not purport to apply to the "upside-down" situation where, in a purchase and sale of all or substantially all assets or of a majority of shares of another corporation, the nominal purchaser is the real seller. Stated otherwise, the Ohio statute (like the Pennsylvania amendments) does not deal with the problem presented by the alternative holding of the *Farris* case. This is just as well since the chances of stating any workable test of an "upside-down" transaction would be almost impossible.

In sum, the Ohio statute is the most thoughtful effort to date...
in this area. Its coverage is adequate, except that its protection of shareholders should extend to issues of more than one-sixth of the shares for acquisitions of less than all assets or less than a majority of shares of another corporation. The other areas of non-coverage are too infrequent or tenuous to call for statutory treatment, unless some court throws a wild card into the game.406

VII. Close Corporations

Since many recent statutory provisions in aid of close corporations have been authoritatively discussed by others,407 this article need only highlight several features less frequently noticed. Some states fail to deal effectively with close corporation problems because they have adopted almost verbatim the Model Act, which so tardily and even reluctantly recognized these issues.408 On the other hand, Connecticut, New York, South Carolina, Wyoming, and Florida409 (in order of enactment of their statutes) have taken significant steps along the path first blazed by North Carolina in 1955. Various statutory provisions bearing on close corporations have been examined elsewhere in this article. Three important topics remain for brief comment.

406 After two opinions in the same jurisdiction construed appraisal right statutes to enable a shareholder of record to vote some beneficially owned shares for, others against, proposed corporate action and still obtain appraisal rights for the dissenting beneficial owners, Reynolds Metals Co. v. Colonial Realty Corp., 40 Del. Ch. 515, 185 A.2d 754 (Ch. 1962), aff'd, 41 Del. Ch. 177, 190 A.2d 752 (Sup. Ct. 1963), several states specifically authorized such a split vote. Bache & Co. v. General Instrument Corp., 74 N.J. Super. 92, 180 A.2d 535, certif. denied, 58 N.J. 181, 183 A.2d 87 (1962); e.g., 3 MODEL Bus. CORP. ACT ANN. § 73 (1960, Supp. 1966); N.Y. Bus. CORP. LAW § 623 (d). Various statutes spell out with particularity rights of a shareholder after he has elected to dissent, e.g., to dividend withdrawal. See, e.g., TEX. BUS. CORP. ACT ANN. art. 5.13 (1956). Statutes usually include a clause purporting to make the appraisal remedy exclusive, whether or not in fact exercised by the shareholder. CONN. GEN. STAT. ANN. § 33-373 (f) (1960); MASS. GEN. LAWS ANN. ch. 156B, § 98 (Supp. 1965).


408 As of today, the Model Act, 3 MODEL Bus. CORP. ACT ANN. (1960, Supp. 1966), recognizes informal action by shareholders, § 138, and by directors, § 39A (a very recent “optional” section); authorizes high vote requirements, § 136; and allows a shareholder to petition for judicial dissolution on grounds most likely to emerge in close corporation situations, § 90. In 1962, the Model Act deleted its requirement of three incorporators, § 47, but it has not yet authorized fewer than three directors even for a one or two-shareholder corporation, see § 34.

409 According to Dean O'Neal, the Florida statute, FLA. STAT. ANN. §§ 608.0100-.0107 (Supp. 1965), is “incomplete and vaguely drawn” and fails to meet the close corporation's “special needs that require changes in the law.” O'Neal, supra note 407, at 651. See Comment, 77 HARV. L. REV. 1551 (1964).
1. Test of “Close Corporations”: Several statutes make certain provisions applicable only to corporations no shares of which are “listed on a national securities exchange or regularly quoted in an over-the-counter market by one or more members of a national or affiliated security association.” A more common variant of the second part of their test is whether the shares are “regularly quoted” or “generally traded.” The unique Florida close corporation law depends upon a similarly worded definition of “close corporation.” Such language no doubt aptly describes the close corporation and, indeed, probably best describes it. However, inherent in this description, which purports to be a definition, is a disturbing uncertainty in its application to practical problems and in some of its implications. Several rhetorical questions suggest some of the difficulties. When do shares become “regularly quoted” or “generally traded”? Assuming \textit{arguendo} that recurrent appearances in the “pink sheets” can be equated with “regular quotations,” no such event signals the beginning of “general trading” in the shares. In any event, during the twilight zone when the close corporation mysteriously transmutes itself into a non-close (if not yet wholly public) enterprise, there may be delicate problems as to rights and liabilities. For instance, where a director restriction agreement is valid only so long as shares are not “regularly quoted” or “generally traded,” who will be liable for action or inaction during this period—the restricted directors or the restricting shareholders?

Once the shares have unquestionably come to be “regularly quoted” or “generally traded,” does it follow that all agreements or arrangements which were valid while the corporation was “close” are now unenforceable? Substantively, this would be unfortunate, for certain arrangements which are most commonly found in close corporations may still be useful (or at least not harmful) in other companies whose shares are beginning to find a limited public market. This would be true, for instance, of various stock transfer restrictions and some management agreements. Once the corporation loses its status under the definition, should not a purchaser of shares with a conspicuous certificate notation of the fact of an agree-
ment or restriction be bound, while another purchaser who knows nothing of such arrangement be relieved of any duty? It would seem more fruitful to focus on means and devices of informing purchasers of arrangements which are unusual or unique rather than to assume that once public trading begins, all or many types of restrictions must ipso facto be invalidated.

While this degree of uncertainty may be tolerated if only one statutory provision or right depended upon such a “test,” it would seem undesirable to ground an entire close corporation statute, even if merely “permissive” like Florida’s, on such shifting sands. It may be time to explore the possibilities of a definition in more definite but possibly arbitrary terms, such as the number of shareholders or some like objective determinants. This is no fantasy. Subchapter S of the Internal Revenue Code already uses as its touchstone the fact of ten shareholders plus certain subordinate criteria not relevant here. Given the many corporations annually qualifying under these provisions, this means that hard money is staked on the assumption that the definition is workable and, in particular, that the corporation can maintain its Subchapter S status through continuing compliance with the standards. A somewhat similar test is used in at least two American corporation statutes which authorize certain stock transfer restrictions so long as there are no more than twenty shareholders. Of particular interest in this connection is the Puerto Rican statute which authorizes a corporation with no more than eleven shareholders to dispense altogether with the board of directors and manage the corporate affairs directly or through a managing agent or officer.

The greatest fund of experience upon which to construct an alternate test of “close corporation” comes from English and Commonwealth statutes defining a “private company” by three criteria:

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414 Section 1371 of the Internal Revenue Code, besides requiring that the corporation have no more than ten shareholders, also bars shareholders other than individuals and estates, and limits the corporation to a single class of stock. INT. REV. CODE OF 1954, § 1371 (a). Stock owned by husband and wife jointly or as community property is deemed owned by only one shareholder. INT. REV. CODE OF 1954, § 1371 (c).

416 In 1963, more than 105,000 corporations elected “Subchapter S treatment.” STEVENS & HENN, CASES ON CORPORATIONS 800 (1965).

418 Wyo. STAT. ANN. § 17-36.32 (d) (1965) authorizes “consent” restraints on transfer “provided that all the shares of the corporation are owned beneficially and of record by not more than twenty shareholders.” TEX. BUS. CORP. ACT ANN. art. 2.22 (B) (2) (1956), authorizes buy-and-sell agreements “so long as there are no more than twenty (20) holders of record” of the class of shares subject to such restrictions.

417 P.R. LAWS ANN. tit. 14, § 1102 (c) (1962).
(1) fifty or fewer shareholders; (2) all shares restricted as to transfer; and (3) public issuance of shares or debentures forbidden by the corporation’s articles. Like Subchapter S, the English Companies Act resolves some of the problems of losing status. While these solutions are not the only possible ones, the greater precision of the number-of-shareholders test makes it possible to construct procedures for dealing with voluntary or involuntary loss of status. The conventional American test of “regularly quoted” or “generally traded” shares simply does not lend itself to such objective and reasonably predictable solutions. Thus, under the English Companies Act, if a company decides to “go public,” in the limited sense of ceasing to be a “private company,” it may do so by filing certain documents. Inadvertent loss of status is harder to deal with, but the English statute vests courts with broad authority to relieve the corporation of the consequences of non-compliance on finding inadvertence or “some other sufficient cause.” Under the Puerto Rican statute, if the corporation comes to have more than the stated number of shareholders, it must act within four months either to reduce the number of shareholders to the number recited within the certificate, amend the articles to specify the new number (still eleven or fewer), or altogether eliminate the stated number in which event it must undertake to elect directors and appoint officers. Failure to comply means that all parties in the corporation, including shareholders and agents, become liable as partners for corporate obligations.

In short, the number-of-shareholders test, which has been so widely used in British and Commonwealth statutes to demarcate the line between private and public companies and which is now used in the Puerto Rican statute to some extent and in the Internal Revenue Code, has a precision and definitude which cannot be readily obtained under the currently favored test in American state statutes. To use the number-of-shareholders criterion as the basis for a close corporation status will require exceptionally careful and percipient statutory draftsmanship, but the task is one worth undertaking.

2. Stock Transfer Restrictions: Recently, at least three states—Connecticut, Wyoming, and Arkansas—have taken significant statu-
tory steps to clarify and enlarge the area of permissible stock transfer restrictions.\textsuperscript{422} At common law, one can be reasonably certain of the validity only of first option and buy-and-sell arrangements.\textsuperscript{423} In only a few jurisdictions can one be confident of the validity of a restriction requiring directors' assent to a proposed stock sale, and then the limits of reasonableness which must govern the directors' giving or denying their consent are not well defined if only because of the sparse judicial authority. Overhanging any novel or unusual approach, even if warranted by good business reasons, is the property law doctrine condemning restraints on alienation.

Among the statutes, Wyoming has the most complete provision to date. It first validates restrictions "in the nature of an option or options or refusal or refusals on any shares," regardless of the number of shareholders.\textsuperscript{424} It next authorizes a restriction "imposed by a buy-and-sell agreement" if all shareholders are parties to the restriction and all shares are owned beneficially and of record by fewer than twenty shareholders. It is not clear why such limitations need be imposed on a buy-and-sell agreement, but both Wyoming and an earlier Texas statute do so.\textsuperscript{425} Most importantly, Wyoming validates a restriction "conditioning the right to voluntarily sell or transfer shares upon the prior consent of the directors or upon the prior consent of all or a portion of the shareholders" if all shares are owned beneficially and of record by twenty or fewer shareholders.\textsuperscript{426} The limitation here seems appropriate, for this type of restriction, particularly as it is worded, should not be available in a larger corporation. In all events, it is assumed that the directors or shareholders must act reasonably in withholding consent.

Connecticut does not attempt to specify the types of valid restrictions, but negatively upholds restrictions "not otherwise illegal" adopted either by by-law or by agreement and applicable either to

\textsuperscript{422} N.C. GEN. STAT. § 55-16(c) (1965) contains a general authorization for the by-laws to include "any provisions for regulation and management of the affairs of the corporation, including the transfer of its shares, and restrictions on such transfer, not inconsistent with the law or the charter." Such a provision on stock transfer restrictions can be read narrowly or restrictively. Happily, North Carolina has a "liberal" attitude towards transfer restrictions. See Wright v. Iredell Tel. Co., 182 N.C. 508, 108 S.E. 744 (1921) (upholding "consent" transfer restriction).

\textsuperscript{423} Certainty as to the validity of buy-and-sell agreements is rather unclear in some jurisdictions.

\textsuperscript{424} WYO. STAT. ANN. § 17-36.32 (b) (1965).

\textsuperscript{425} Tex. Bus. Corp. Act art. 2.22 (B) (2) (1965); WYO. STAT. ANN. § 17-36.32 (c) (1965).

\textsuperscript{426} WYO. STAT. ANN. § 17-36.32 (d) (1965).
those shares voting for the by-law or to those party to the agreement. These restrictions also apply to any shares subsequently issued if so provided in the by-law or agreement.\textsuperscript{427} The use of the “not otherwise illegal” phrase is unfortunate. It leaves an opening for judicial restrictiveness, since there is case law (although not necessarily in Connecticut) treating almost every type of restriction as “illegal” at some time or other. Unless a jurisdiction is known to have an exceptionally liberal view of stock transfer restrictions, the phrase is dangerous or, at least as bad, uncertain and unpredictable in its application to particular restrictions.

The Arkansas statute apparently is intended primarily as an enabling provision codifying the common law rule.\textsuperscript{428} It authorizes share transfer restrictions “that do not unreasonably restrain alienation,” and includes “purchase options” and “a prior offering to the corporation or to one or more of its shareholders, at a fair price” before transferred outside the corporate family.\textsuperscript{429} Unlike Wyoming, it does not in terms include consent arrangements.\textsuperscript{430} It is also broader than other statutes in authorizing restrictions on transfers inter vivos and by inheritance or testamentary gift, and “hypothecation or other disposition” of the shares.\textsuperscript{431} For shares yet to be issued, the restrictions must appear in the articles or by-laws and be conspicuously noted on the certificate;\textsuperscript{432} for outstanding shares, the owner’s consent is required.

These statutes make a beginning, but they do not go far enough to accommodate adequately the needs of the close corporation. It is evident that they would not authorize an absolute restraint on alienation even for a limited time period, nor is it clear that they

\textsuperscript{427} CONN. GEN. STAT. ANN. § 33-306 (a) (1960). Shares issued subsequent to an agreement containing a stock transfer restriction are subject to the restriction if the agreement was accepted by shareholders who had sufficient voting power to adopt a by-law to that effect. Thus, in this instance, the statute interestingly eliminates any functional distinction between a shareholder agreement and a by-law provision.
\textsuperscript{428} 2ARK. STAT. ANN. § 64-211 (1966). The Corporation Law Revision Committee’s Note to this section states that “there might as well be some statutory authority” for by-law provisions creating stock transfer restrictions since “lawyers are often asked to prepare” them.
\textsuperscript{429} 2ARK. STAT. ANN. § 64-211 (A) (1966).
\textsuperscript{430} 2ARK. STAT. ANN. § 64-211 (B) (1966).
\textsuperscript{431} 2ARK. STAT. ANN. § 64-211 (C) (1966) states that nothing in the statute precludes a shareholder from making a “personal contract or agreement” containing restrictions “that do not unreasonably restrain alienation,” but it is difficult to see what this adds to the general authority to make restrictions under 2ARK. STAT. ANN. § 64-211 (A) (1966).
\textsuperscript{432} 2ARK. STAT. ANN. § 64-211 (A) (1966).
would validate the lesser restriction of barring transfer of restricted securities to designated persons or classes of persons. It would be welcome to see statutes expressly recognize restrictions not only on a transfer in the sense of a sale or other disposition of the security, but in the sense of “transfer on the books.” Such a restraint on registration of transfer (to adopt Uniform Commercial Code language)\footnote{Uniform Commercial Code \S\S 8-102 (1) (c), -106, -401.} is needed both for close corporations and for sales of securities under a “private placement” or “intrastate” exemption in state or federal securities laws.\footnote{Securities Act of 1933, \S\S 3-4, 48 Stat. 75, as amended, 15 U.S.C. \S\S 17c-d (1964).} It is also worth noting that, except for Connecticut, no statutes deal with restrictions on securities other than shares, but it may be vitally necessary to control the disposition of convertible bonds, debentures, or (much more rarely) preferred shares and the shares into which they may be converted. Finally, one of the subtle dangers of statutes such as Wyoming’s is that they might be deemed pre-emptive of restrictions not explicitly covered by the statute’s terms. At least Connecticut avoids that problem, whatever other difficulties it creates, by the broad phrase “otherwise lawful.” It would be better, however, to list permissible forms of stock transfer restrictions and then add a clause saving other restrictions which may be lawful.

3. Remedies on Deadlock: The conventional remedy for deadlock is dissolution ordered at the discretion of the court. As Model Act section 90,\footnote{ABA-ALI Model Bus. Corp. Act \S 90 (1953).} it has found its way into all of the new corporation law revisions, usually with variations although with its basic concepts unchanged. It seems generally accepted by commentators that ready dissolution on deadlock is desirable,\footnote{See, e.g., Israels, The Sacred Cow of Corporate Existence—Problems of Deadlock and Dissolution, 19 U. Chi. L. Rev. 778 (1952).} although courts have been noticeably hesitant to order the remedy even when the statute broadly empowers them.\footnote{Sec, e.g., Jackson v. Nicolai-Neppach Co., 219 Ore. 560, 348 P.2d 9 (1959).} The courts may well be more perceptive than the writers, for their reluctance suggests their recognition that dissolution irrevocably ends a formerly viable concern, which might have been revived if the corporation’s life had continued and the deadlock broken. In general, the judicial opinions indicate a deep disquiet and disinclination to rely too much on dissolution as the way out. Hence, those states which have in one
way or another provided alternative remedies have made a considerable advance over those which give courts (and counsel) only the choice between dissolution or no dissolution. Three such alternative remedies which are found in a few of the new statutes are briefly noted.

(a) **Provisional Director:** California’s familiar procedure for appointing a provisional director—once unique to that state but now adopted in Missouri—is perhaps the least drastic remedy since it touches symptoms rather than causes. Under this statute’s wording, given a deadlock of an evenly divided board, half of the directors or one-third of the shareholders may petition for a court order designating an “impartial person” to serve as director until he is removed by the court or ousted by a majority of the shareholders. The provisional director is vested with all powers of the other directors, including the rights to notice, to attend meetings, and to vote.

This procedure is essentially a means of compelling the warring shareholders and directors to accept a type of arbitration. The deadlock-breaking director acts independently and presumably for the best interests of the corporation, as those interests are viewed by an outsider. The statute assumes that his supposedly dispassionate approach, unwarped by prior involvement in the internecine strife, will enable him to work with the other parties towards a resolution of the conflict, and having done so, that he will bow out without permanently altering the balance of power within the corporation. The supposed advantages of this remedy are thus predicated both upon his power to cast a deciding vote to break deadlocks on the director level and upon his persuasiveness in pressing new ideas or alternatives or by acting as mediator or conciliator.

As suggested, the remedy goes to symptoms primarily, although possibly the deadlock-breaking votes of a provisional director may so change the direction of corporate activity that deadlock will not recur. However, this may be too hopeful, for in many cases, the matrix of the deadlock may be the incompatibility of the principals or of their ideas; and in this situation the provisional director may only postpone the day when more drastic remedies must be invoked.

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440 Both the California and Missouri statutes provide that the appointee must not be either a shareholder or creditor of the corporation nor related within the third degree to any other directors or officers of the corporation,
(b) Compulsory Buyout of Shares: Going well beyond the provisional director is the court-ordered buyout of a dissenting stockholder.\textsuperscript{441} This remedy was first clearly established in England under section 210 of the Companies Act,\textsuperscript{442} and it has been adopted throughout the Commonwealth.\textsuperscript{443} In general, section 210 empowers the court to exercise broad powers in granting relief whenever it finds that dissolution is appropriate but that dissolution would prejudice one or more shareholder groups. In such a case the court may order, among other forms of relief, "the purchase of the shares of any members of the company by other members of the company or by the company . . .," at a fair price fixed by the court. Thus, it resembles somewhat the shareholder appraisal remedy in a merger or sale of assets, since money compensation is awarded for the injury sustained. This procedure, of course, enables the majority to force out the minority subject to court approval. However, it is not perhaps as hard on the minority interests as a first glimpse suggests. No doubt, the court will generously calculate "fair value" in aggravated circumstances to favor the minority. Moreover, under the English statute it is truly an alternative to dissolution since buyout is not ordered unless dissolution would itself be appropriate. Thus, the statute assumes that the situation is so bad that the status quo ante is beyond restoration. Buyout is therefore preferable, for at least it averts potential destruction of going-concern values, while fairly treating the ousted interests. Indeed, the minority may be glad to get out, so long as they can get a fair price, which presumably the court will guarantee them.

Three states make the substance of this remedy available. South Carolina does so through its adoption nearly verbatim of England's section 210 including the power to order buyout.\textsuperscript{444} Connecticut's statute\textsuperscript{445} is less inclusive than the English and South Carolina pro-

\textsuperscript{441} The English and Connecticut statutes considered in this section have some vague antecedents in statutes in West Virginia, W. VA. CODE ANN. § 3093 (1961), and California, CAL. CORP. CODE § 4658, which permits any holder of fifty per cent or more of a corporation's shares to "buy off," with court approval, an action to appoint a receiver for a corporation or to dissolve it. See Merlino v. Fresno Macaroni Mfg. Co., 64 Cal. App. 2d 462, 148 P.2d 884 (Dist. Ct. App. 1944).

\textsuperscript{442} Companies Act, 1948, 11 & 12 Geo. 6, c. 38, § 210.

\textsuperscript{443} E.g., Companies Code, 1961, § 218 (Ghana); Companies Act, Act No. 65 of 1955, § 209 (N.Z.); Companies Act, 1960, 9 Eliz. 2, c. 22, § 201 (No. Ireland); Companies Act, 1962, § 186 (So. Aust.); Companies Act, 1959, § 128 (Tasmania); Companies Act, 1958, § 94 (Vict.). Similar statutes are also found in India and South Africa.

\textsuperscript{444} S.C. CODE ANN. § 12-22.23 (Supp. 1965).

\textsuperscript{445} CONN. GEN. STAT. ANN. § 33-384 (1960), as amended, §§ 33-384 (b), (d), (e) (Supp. 1965).
visions in the potential variety of court-ordered remedies, but is more precise and comprehensive in its coverage of the possibly tricky procedural problems inherent in the compulsory buyout. Under the Connecticut statute, once a shareholder has sued to compel dissolution of the corporation, for example, because of deadlock or fraud, "any other shareholder" may petition the court to determine the fair value of the shares owned by the plaintiff in the original dissolution action. Under the statute, the court "shall" determine the fair value, using appraisers if necessary. After the report is made on fair value, the "other shareholder" may elect to purchase the plaintiff's shares at the appraised figure. On depositing funds for the purchase, the court must enter an order of sale compelling the plaintiff to turn over his shares duly endorsed for transfer. In 1963, Montana adopted a provision somewhat similar to Connecticut's by authorizing the holders of fifty per cent or more of the outstanding shares to procure dismissal of a dissolution suit by a court-ordered purchase, at fair value, of the shares of the complaining shareholder. 446

Obviously, any shareholder will think twice before suing to compel dissolution if he may thereby involve himself in a procedure which will compel him to sell out his stock interest. This is especially so if he incurs a large tax, as he might if his basis is low. Hence, the overall position of the minority shareholder may in fact be weakened. On the other hand, if the majority interests find that they have to buy off the suit at a large cost to themselves or face dissolution, this may deter unconscionable conduct and perhaps initiate fruitful changes in the relationships within the corporation. Perhaps the main criticism of the Connecticut statute is its seeming withdrawal of discretion from the court to determine whether to order sale. Once the shareholder who seeks to buy off the dissolution suit applies for appraisal, the procedure which apparently follows is automatic and mandatory, since the court "shall" determine fair value and, if the applicant elects to buy the shares at fair value, the court "shall" enter the order of sale. It would seem better to leave the court some discretion, as under the English statute, to determine whether to order a buyout. On the other hand, the Connecticut provision is an advance over the English statute since Connecticut does not require that the court must first find that

dissolution is appropriate and then order buyout as an alternative.

(c) "Section 210 Relief": Section 210 of the English Companies Act[447] and its many sister provisions in Commonwealth statutes[448] offer the most comprehensive relief. Besides the compulsory buyout of shares, the English "court may, with a view for bringing to an end the matters complained of, make such order as it thinks fit, whether for regulating the conduct of the company's affairs in the future," including "any alteration in or addition to any company's memorandum or articles." In *Scottish Co-op. Wholesale Soc., Ltd. v. Meyer*,[449] the court ordered a compulsory buyout of the shares of two minority shareholders who were being virtually persecuted by the majority stock interest in its efforts to force sale of the minority interests at a sacrifice price; the court fixed a fair price which it defined as "the value which the shares would have had at the date of the petition, if there had been no oppression" of the minority shareholders.[450] In another case, the court kicked a domineering, senile majority shareholder upstairs into an honorary and impotent executive position and isolated him from any significant contact with company affairs, but left his shareholdings intact rather than shift stock control as the petitioners had requested.[451] In a more restrictive mood, the Court of Session of Scotland refused any relief, however merited by the facts, to a shareholder who had been thrown out of his corporate office on the ground that the statute as worded remedies only injuries to a shareholder *qua* shareholder but not *qua* director or officer.[452] This narrow construction withholds the statute's compulsion from an area of major concern in a close corporation, that is, a shareholder's interest in a possibly lucrative director or officer post. Such a construction would be overruled by an amendment recommended by the Jenkins Committee.[453]

Perhaps the most serious restriction in existing section 210 is the fact that judicial relief is not available unless the court first determines that the situation warrants dissolution. Then if dissolution would be in order, the alternative relief may be granted, but not otherwise. The Jenkins Committee, viewing section 210 as a man-

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[448] E.g., statutes cited note 445 supra.
[450] Id. at 369.
date for courts to grant all needed relief for breach of duty and oppression of minority interests, has recommended that the remedy be cut loose from its present connection with dissolution, so that the “alternative” relief will be available on a showing of need, whether or not the situation is so serious as to justify dissolution. This tie has been clearly severed in the Northern Ireland and Ghana versions of section 210, and will be in England if Parliament adopts the Jenkins Committee recommendations.

South Carolina alone among American jurisdictions has adopted the section 210 idea and vested the courts with the same sweeping discretion as its English prototype. Under the South Carolina statute, the tie between dissolution and alternative relief is broken, and relief may be awarded either “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.” Thus, injury not calling for so drastic a remedy as court-ordered liquidation may be relieved by a forced share purchase, or by a change in the by-laws or articles of incorporation, or by some other form of relief tailored to the facts of the case. Also under the South Carolina statute, relief is available to a shareholder whether he is injured in his capacity of shareholder, director, or officer of the corporation, thereby precluding the restrictive construction of the English statute from being read into the South Carolina law.

CONCLUSION

The years 1959-1966 have been a most significant period of development in corporation law. On the state level, perhaps the major accomplishments, besides simplification and clarification of statutes, have been the increasingly perceptive recognition of close corporation needs, particularly through separate statutes such as Florida's.

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454 Id. at 75-78.
455 Companies Code, 1961, § 218(2) (Ghana); Companies Act, 1960, 9 Eliz. 2, c. 22, § 201 (3) (No. Ireland).
457 S.C. CODE ANN. § 12-22.23(b) (Supp. 1965).
458 Under the South Carolina statute, persons having standing to petition for judicial dissolution may also seek relief under South Carolina's version of § 210. Under S.C. CODE ANN. § 12-22.15 (a) (4) (Supp. 1965), one may petition for dissolution on the ground that “the acts of the directors or those in control of the corporation . . . . (B) are oppressive or unfairly prejudicial either to the corporation or to any shareholder whether in his capacity as a shareholder, director or officer of the corporation.” Hence, on showing such damage, one may also seek the relief provided for under S.C. CODE ANN. § 12-22.23 (Supp. 1965).
and the halting efforts towards uniform rules governing all forms of corporate fusions. On the other hand, state statutes are obviously becoming increasingly lax as they give management more and more leeway in handling corporate affairs. This negative development is partially offset by the gradual evolution of higher fiduciary standards for directors, officers, and (in some areas) controlling shareholders, and particularly by the rapid growth of "federal corporation law," most evident in the 1964 Securities Acts Amendments. Thus the overall balance is between increasing state law permissiveness and widening federal regulation—a development not without parallel in other areas of life and law.