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Hooray (?) For The Model Act—The 1969 Revision And The Close Corporation

ROBERT A. KESSLER*

I. INTRODUCTION

There are three preeminent corporate statutes in the United States. The first is New York's, for that state has more corporations than any other state.1 The second is Delaware's, for that state is the home of most of the large corporations.2 And, the third is the Model Business Corporation Act, for that statute has been enacted in so many of the remaining jurisdictions.3

The draftsmen of the Model Act, the Committee on Corporate Laws of the Section of Corporation, Banking and Business Law of the American Bar Association, only take credit for adoption of their Act in twenty states.4 However, since it was first proposed in 1950,5 virtually every state has either enacted a new corporation law or substantially revised its existing one, and every one of these statutes has been influenced by the Model Act. The extent of borrowing has differed from state to state, but even the New York and Delaware statutes have been affected.6

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1. "From statistical studies prepared by Dun & Bradstreet, Inc., as of 1964, the figures show that in number of businesses incorporated annually, the sixteen Model Act states accounted for 40 thousand new incorporations or slightly more than one-fifth of the total 197 thousand, followed by New York with 36 thousand (about eighteen percent), and California with 16 thousand (eight percent). Delaware was twelfth with 4 thousand (approximately two percent). The ratio has remained relatively constant through 1966 (see Dun & Bradstreet, Inc., Release of Feb. 15, 1967, Monthly New Incorporations, No. 1)." R. Baker & W. Cary, Cases and Materials on Corporations 3 (3d ed. Supp. 1968).

2. "Delaware became and remains the most popular state in which to incorporate any interstate company of substantial size. To illustrate, of the approximately 1,250 corporations listed on the New York Stock Exchange on January 4, 1965, 433 or 35 percent were Delaware corporations. New York was second with 164 or 13 percent; New Jersey had seven percent and none of the rest had as much as 5 percent. (Seward, Basic Corporate Practice (A.L.I-A.B.A. 1966), p. 9)." R. Baker & W. Cary, supra note 1, at 2. See also R. Stevens & H. Henn, Law of Corporations 26-28 (1965).

3. See note 1 supra.

4. "In the 19 years since the Model Business Corporation Act was reported by the Committee on Corporate Laws to the Section of Corporation, Banking and Business Law, it has become a major point of reference in the continuing revision of state corporation acts. It has been adopted in substance in 20 states and major portions have been followed in many others." Preface to ABA-ALI Model Bus. Corp. Act at iii (rev. ed. 1969) [hereinafter cited as Model Act].

5. Id. The Act was, however, originally drafted in 1946. Preface to 2 Model Bus. Corp. Act Ann. at V (1960).

6. See, e.g., N.Y. Bus. Corp. Law, Comments, §§ 102, 201-03, 301, 303, 402, 404, 501,
It is fair to say, then, that if there is a typical American corporation statute it is the Model Business Corporation Act.

In the nineteen years since it was first proposed, the Model Act has been amended a number of times, and revised versions have been published. The 1969 revision has recently been promulgated. The changes embodied in this edition are, in the Committee's words, "the most numerous and the most significant that have been made since its publication in 1950." 7

This new version of the Act, like the original version, 8 will undoubtedly be the subject of extensive comment and analysis in the nation's law reviews. The original Act was "liberal" or "enabling," and was, accordingly, hailed by lawyers for large corporations, and condemned by those concerned with "corporate democracy" and minority shareholders' rights. Since the new Act is even more "liberal" and "enabling" than the old one, corresponding praise and condemnation from the same quarters can be anticipated as to the statute's "public issue" aspects.

Today, however, the emphasis has changed. Inevitably, state statutes will become more "management oriented" in the probably vain attempt to entice large and medium-sized corporations to abandon Delaware for incorporation in equally or even more permissive jurisdictions. Therefore, the stress is now on the new statutes' adequacy to meet the needs of "close" corporations, i.e., those formed with a small amount of capital by a few persons, usually friends or relatives, who regard themselves as "partners."

All recent corporation statutes have included some provisions designed to favor such close corporations. A few, notably those of Florida, 9 Maryland, 10 and Delaware, 11 recognize close corporations as a separate species, and thus, have special sections explicitly applicable only to them.

The draftsmen of the new Model Act expressly rejected such special statutory treatment. Instead, they preferred to leave to the close corporate practitioner the task of choosing from among those provisions

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7. Model Act at iii.
generally made available by the Act those best suited to his clients' needs. The Committee obviously felt that the devices proffered were sufficient to satisfy the requirements of the small incorporated business. Its correctness in this conclusion is best assessed by comparing the close corporation's needs with the new Act's statutory provisions designed to meet them.

Although all close corporations do not have the same needs, it is recognized that most active participants in close corporations have certain common desires. As a result, an evaluation of the Model Act in terms of its treatment of such desires is justified.

The first desire is self-survival, i.e., control over the admission of new participants. This is frequently called the principle of _delectus personarum_, keeping the close corporation close. The instrument for securing this desideratum is, of course, the share transfer restriction.

In addition, although all participants may not want the same power structure, they do all want the freedom to depart from the old shareholder-director paradigm, whereby a plurality of the shares elect a completely autonomous, noncommitted (i.e., not bound by any advance agreement) board of at least three directors to whom all management must be confided. In short, the second recognized desire is freedom to mold the power structure.

Lastly, small businessmen cannot afford expensive legal talent to lead them through organizational and operational labyrinths. Consequently, simplicity as to both, or the avoidance of "red tape," is the participants' third common desire.

Disputes in a close corporation are not only more acrimonious than

12. "The subject of close corporations calls for comment because of numerous suggestions that special statutory treatment would be useful. This view has been considered by the Committee over a period of years. Its conclusion is that the Model Act provides the flexibility required for ease of creation, management and administration of a close corporation without raising the problems that are generally posed by such a special statutory provision.

"For those interested in exploring the freedom of action permitted by the Model Act, reference is particularly invited to Section 35 concerning management, Section 16 permitting variations in series and restrictions on voting rights, Sections 32 and 143 with reference to quorums of shareholders, Section 34 authorizing shareholder agreements, Sections 36 and 53 dealing with the number of directors and Incorporators, and Section 37 concerning classification of directors, Section 40 as to quorum of directors, Section 54 authorizing restrictions on transferability of shares, and Sections 44 and 145 permitting action by directors and shareholders without a meeting. Other sections add to the liberality afforded. The experienced practitioner is afforded a wide variety of devices for tailoring a close corporation to his clients' needs." Model Act at iii-iv.

In contrast to the Florida, Maryland and Delaware statutes, the Model Act nowhere uses the term "close corporation." (It does not even appear in the Index).
in public issue corporations, they are also more apt to paralyze the business to the detriment of all participants. The effectiveness of the Model Act's provisions designed to assist small business, therefore, must also be gauged in terms of the means provided to resolve such internecine disputes.

There are always other provisions of a corporation statute of some interest to close corporations. Although adjunctive to the sections relevant to the enumerated desires, they are more conveniently treated under the miscellaneous category which will form the last portion of this article.

II. KEEPING THE CORPORATION "CLOSE"

Most close corporations desire to impose "restrictions" on the transferability of their shares of stock. The reason, of course, is that such stock carries with it an "intrusion power." Realistically, in a public issue corporation forty shares out of several hundred thousand carry no say in how the corporation will be operated. In a close corporation, however, the same number of shares may, even if perhaps only negatively, determine how the business will be run. Moreover, stock ownership in a close corporation is not only, and often not primarily, a right to share in profits, but also a pledge of the owner's active participation in the work of the business. Consequently, control over share transfers is, obviously, necessary to prevent the intrusion of obfuscators (even the widows of former owners often fall into that category) and to insure that only active participants will be admitted into the corporation.

With the notable exception of Delaware's statute, most corporation statutes (including New York's) are silent on the problem. Delaware, however, has the most elaborate provisions in the country. Departing

13. The term "share restrictions" is today used in a broad sense to include binding agreements to repurchase as well as mere limitations on free transferability. See, e.g., Del. Code Ann. tit. 8, § 202 (Supp. 1968). Under this use of the term, "share restrictions" also perform the function of insuring a fair return to a retiring member or the family of a deceased participant. Even under the more limited use of the term, there are, of course, other important functions which such restrictions can perform, such as maintaining the proportionate interest of present members, avoiding termination of a Subchapter S tax election, and possible loss of exemption under the Federal Securities Act of 1933. See Henn, Book Review, 38 Fordham L. Rev. 146, 151 n.28 (1969). See also 2 F.H. O'Neal, Close Corporations: Law and Practice § 7.03 (1958).


"(a) A written restriction on the transfer or registration of transfer of a security of a corporation, if permitted by this section and noted conspicuously on the security, may be enforced against the holder of the restricted security or any successor or transferee of the holder including an executor, administrator, trustee, guardian or other fiduciary entrusted with like responsibility for the person or estate of the holder. Unless noted conspicuously on the security, a restriction, even though permitted by this section, is ineffective except against a person with actual knowledge of the restriction.

(b) A restriction on the transfer or registration of transfer of securities of a corporation
from American tradition, it not only permits, but also requires close
corporations to impose some restrictions on share transfers. In addition,
it generally validates all "legal restrictions," and expressly validates
the commonly recognized first offer and buy-sell arrangements, the more
dubious consent agreements, and (unless "manifestly unreasonable")
the prohibited transferee plans. The new Model Act, carrying over the
earlier version of the Act, contains none of these provisions. The Act
merely includes a general authorization for share restrictions. Section 54,
captioned "Articles of Incorporation," provides:

may be imposed either by the certificate of incorporation or by the by-laws or by an
agreement among any number of security holders or among such holders and the corpora-
tion. No restriction so imposed shall be binding with respect to securities issued prior to
the adoption of the restriction unless the holders of the securities are parties to an agree-
ment or voted in favor of the restriction.

(c) A restriction on the transfer of securities of a corporation is permitted by this sec-
tion if it:
(1) Obligates the holder of the restricted securities to offer to the corporation or to any
other holder of securities of the corporation or to any other person or to any combination
of the foregoing, a prior opportunity, to be exercised within a reasonable time, to acquire
the restricted securities; or
(2) Obligates the corporation or any holder of securities of the corporation or any other
person or any combination of the foregoing, to purchase the securities which are the subject
of an agreement respecting the purchase and sale of the restricted securities; or
(3) Requires the corporation or the holders of any class of securities of the corporation
to consent to any proposed transfer of the restricted securities or to approve the proposed
transferee of the restricted securities; or
(4) Prohibits the transfer of the restricted securities to designated persons or classes of
persons, and such designation is not manifestly unreasonable.
(d) Any restriction on the transfer of the shares of a corporation for the purpose of
maintaining its status as an electing small business corporation under subchapter S of the
United States Internal Revenue Code is conclusively presumed to be for a reasonable pur-
pose.
(e) Any other lawful restriction on transfer or registration of transfer of securities is
permitted by this section.

Del. Code Ann. tit. 8, § 342 (Supp. 1968) provides that:
"(a) A close corporation is a corporation organized under this chapter whose certificate
of incorporation contains the provisions required by section 102 of this title and, in addi-
tion, provides that:
(1) All of the corporation's issued stock of all classes, exclusive of treasury shares, shall
be held of record by not more than a specified number of persons, not exceeding thirty;
and
(2) All of the issued stock of all classes shall be subject to one or more of the restrictions
on transfer permitted by section 202 of this title; and
(3) The corporation shall make no offering of any of its stock of any class which would
constitute a "public offering" within the meaning of the United States Securities Act of
1933, as it may be amended from time to time.
(b) The certificate of incorporation of a close corporation may set forth the qualifica-
tions of stockholders, either by specifying classes of persons who shall be entitled to be
holders of record of stock of any class, or by specifying classes of persons who shall not
be entitled to be holders of stock of any class or both.
(c) For purposes of determining the number of holders of record of the stock of a close
corporation, stock which is held in joint or common tenancy or by the entireties shall be
treated as held by one stockholder."
15. ABA-ALI Model Bus. Corp. Act § 48(i) (1953) [hereinafter cited as Old Model
Act].
The articles of incorporation shall set forth: . . . (h) Any provision, not inconsistent with law, which the incorporators elect to set forth in the articles of incorporation for the regulation of the internal affairs of the corporation, including any provisions restricting the transfer of shares and any provision which under the Act is required or permitted to be set forth in the by-laws.

Although the clause as to share restrictions says "any provision," the authorization is probably circumscribed by the general limitation, "not inconsistent with law." If so, the statute's effect is to incorporate the enacting state's common law as to permissible restrictions. Ordinarily, this will mean the validation of first offer and buy-sell arrangements, and the invalidation of the more stringent restrictions, such as consent and prohibited transferee provisions.16

While in most circumstances the permitted restrictions will be sufficient for the needs of close corporations, the Act's general language may well result in the hampering of legitimate close corporation objectives. This hampering is, in part, due to the carry-over of the Act's companion filing provision with its "conformity to law" requirement. New section 55, mirroring old section 49, only requires the secretary of state to file the articles of incorporation if he finds that they "conform to law." Some secretaries of state take such provisions as a legislative directive that they scrutinize all provisions in the articles for possible invalidity, and that they reject all documents which contain provisions which are not clearly authorized. This requires them, in their view, to sit simultaneously as court and prosecuting attorney against the lawyer who has drafted the document. They view their filing of the articles as somehow conferring the state's seal of approval on everything the articles contain. With such a view of their role, these secretaries tend to be extremely conservative. Frequently, too, because of the press of their routine duties, they are even unaware of recent judicial decisions authorizing provisions which to them seem "wrong." Since they know their power, they can be quite intransigent. The lawyer's sole alternative is to use only "standard" provisions, or mandamus the secretary with the possibility of litigation to the highest state court, and the certainty of being


Although the Act should not be narrowly interpreted, it could be argued that, under it, share restrictions not contained in the articles (i.e., imposed by the bylaws or separate agreement) are not valid. Patterns for improvement of the Model Act provision were widely available, but, unfortunately, not utilized. See, e.g., R.I. Gen. Laws Ann. § 7.1-1.21-1 (Supp. 1969) which expressly allows the imposition of restrictions by bylaws or shareholder agreement, as well as by a certificate of incorporation (articles) provision. See also Del. Code Ann. tit. 8, § 342 (Supp. 1968); Md. Ann. Code art. 23, § 101 (Supp. 1969) requiring share restrictions in close corporations; N.J. Stat. Ann. § 14A:7-12 (1969).
branded a "troublemaker," a reputation which will not help him in future dealings with the department.

The choice is obvious, and results in the stifling of experimentation. For example, it may well mean the yielding of restrictions designed to protect a Subchapter S tax election, and those designed to debar transfer to a competitor because they both qualify as "absolute prohibitions" on transfer.

III. MOLDING THE POWER STRUCTURE

Although some very large corporations with widely dispersed shareholdings have been aptly described as "self-perpetuating oligarchies," today's ideal corporation is still a plutocracy in which the people with the greater financial stake dominate daily management, and, increasingly (because of the widespread reduction to a mere majority in the number of shareholder votes required to approve even fundamental changes) the entire fate of the corporate venture. This majority plutocracy is not, however, acceptable to most close corporations. Ordinarily, such corporations want a form of "people power," in which brains are as important as money in running the corporation. But, sometimes, as in the "one-man" corporation, what is wanted is an even more complete plutocracy than the ordinary rules give, i.e., complete control by the real investor even though others may have a nominal participation in the enterprise.

In the past, corporation laws, at least as interpreted, have usually stood in the way of such deviancies. Thus, attempts to give an individual voting power disproportionate to his financial participation were frequently struck down. The classic cases were *Benintendi v. Kenton Hotel, Inc.* and *Jackson v. Hooper.* The "one-man" corporation's desire to give the dominant participant disproportionate control was also frustrated by the requirements of a three-member board, and the frequent concomitant statutory provision demanding that all directors be shareholders.

Starting with New York's 1948 amendment to section 9 of the old Stock Corporation Law which permitted high vote and high quorum

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20. 76 N.J. Eq. 592, 75 A. 568 (Ct. Err. & App. 1910). See also Nickolopoulos v. Sarantis, 102 N.J. Eq. 585, 141 A. 792 (Ct. Err. & App. 1928) which held invalid an agreement whereby a twenty-five percent shareholder was given a fifty percent vote as a shareholder and director.
requirements for director and shareholder action, the obstacles to free intra-corporate power allocation have, for the most part, been swept away. Today, most states grant statutory permission for high vote and quorum, thus allowing a minority holder to exercise a control greater than his financial participation would otherwise permit.22

The "one-man" corporation is now widely allowed to dispense with superfluous directors, and to confine complete control in the sole owner, alternately wearing either his shareholder or director "hat."23 Where there are other investors, however, full management control in the principal participant has not been so widely recognized.24

The Model Act was an early follower of the New York high vote high quorum provision,25 and retained this permission in the new version.26 Also carried over was the somewhat anomalous authorization for high vote and quorum, as well as high shareholder vote in the bylaws, while restricting high shareholder quorum to the articles of incorporation.

25. See Old Model Act §§ 30, 37, 136.
26. Model Act § 143 provides that:
"Whenever, with respect to any action to be taken by the shareholders of a corporation, the articles of incorporation require the vote or concurrence of the holders of a greater proportion of the shares, or of any class or series thereof, than required by this Act with respect to such action, the provisions of the articles of incorporation shall control."
Model Act § 32 provides that:
"Unless otherwise provided in the articles of incorporation, a majority of the shares entitled to vote, represented in person or by proxy, shall constitute a quorum at a meeting of shareholders, but in no event shall a quorum consist of less than one-third of the shares entitled to vote at the meeting. If a quorum is present, the affirmative vote of the majority of the shares represented at the meeting and entitled to vote on the subject matter shall be the act of the shareholders, unless the vote of a greater number or voting by classes is required by this Act or the articles of incorporation or by-laws."
Model Act § 40 provides that:
"A majority of the number of directors fixed by or in the manner provided in the by-laws or in the absence of a by-law fixing or providing for the number of directors, then of the number stated in the articles of incorporation, shall constitute a quorum for the transaction of business unless a greater number is required by the articles of incorporation or the by-laws. The act of the majority of the directors present at a meeting at which a quorum is present shall be the act of the board of directors, unless the act of a greater number is required by the articles of incorporation or the by-laws."
If the rationale is accepted that all significant management provisions should be in the charter, because this is a public document that can more fairly be held to give notice than the bylaws, then, consistent with the New York pattern, all such provisions should be required to be in the articles. Such a requirement, however, frequently poses a trap for the clients of the unwary lawyer. The simpler procedure would be to allow all such provisions in the bylaws, or even a separate agreement, but to deny the bylaw's or agreement's validity as to a non-consenting shareholder without notice. Although a legend on share certificates containing such a legend could conclusively be presumed to be notice of and assent to such a bylaw or agreement provision.


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

(a) Management of the business of the corporation.

(b) Declaration and payment of dividends or division of profits.

(c) Who shall be officers or directors, or both, of the corporation.

(d) Restrictions on transfer of stock.

(e) Voting requirements, including the requirements of unanimous voting of stockholders or directors.

(f) Employment of stockholders by the corporation.

(g) Arbitration of issues as to which the stockholders are deadlocked in voting power or as to which the directors are deadlocked and the stockholders are unable to break the deadlock.

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

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

30. Id.


32. See, e.g., R.I. Gen. Laws § 7.1-1.51 (1969) which provides that notice of close corporation provisions is conclusively presumed if under the corporation's name the corpora-
Although the new Model Act does not, then, in this respect, represent an advance over current law, it has made gains in another area. Specifically, the Act goes beyond the current less-than-three director statutes by not limiting the paucity of directors to the number of shareholders. Model Act section 36, departing from the old text, provides that: "[t]he board of directors of a corporation shall consist of one or more members."

The usual qualification that the number of directors shall in no event be less than the number of shareholders has been omitted. Thus, presumably, a corporation with, for example, three shareholders can still have a one director "board." Although perhaps dangerous in some close corporations, this permission should prove useful as part of a tax saving device in a number of family corporations. It represents, therefore, a valuable addition to corporate management flexibility.

An even more significant contribution to management flexibility is the apparent statutory permission to dispense with the board entirely, should the corporation desire to do so. Model Act section 35, radically changing the corresponding provisions of the old Act, provides:

The business and affairs of a corporation shall be managed by a board of directors except as may be otherwise provided in the articles of incorporation. If any such provision is made in the articles of incorporation, the powers and duties conferred or imposed upon the board of directors by this Act shall be exercised or performed to such extent and by such person or persons as shall be provided in the articles of incorporation.

Very few current corporation statutes go this far. With Model Act "approval," in the future, many more can be expected to follow suit.

33. Old Model Act § 34.
35. It would be dangerous to a minority shareholder to accept shares in a corporation wherein a mere majority will elect the only director(s).
36. It would be useful to a father running a business. During his lifetime, he could issue shares to members of his family, thus avoiding the death taxes which would be imposed on gifts of the shares on his death, while, at the same time, retaining full control during his life. Careful tax planning is, of course, necessary. See, e.g., Int. Rev. Code of 1954, §§ 541-47.
As writers have argued before, the board of directors is frequently a superfluity for the close corporation. Management power can more easily be allocated on the shareholder than the director level, since on the shareholder level it can be proportioned by the simple device of share issuance. Although less circumlocutive language (e.g., that a corporation need not have a board if its articles so provided) would have been desirable, "the sentiment is there."

Such permitted deprivation of board power also assists the close corporation practitioner in more easily accomplishing the power distribution his client desires. It does this by transferring participant agreements from the widely prohibited "director-impinging" category to the ordinarily permitted shareholder classification.

Today, even in the absence of statute, shareholder "pooling" agreements are normally regarded as valid, and enforceable. However, at common law, where such agreements bound their signatories as to voting in their director capacity, they were normally invalid. The new Model Act (section 34) recognizes and reinforces the current rule:

Agreements among shareholders regarding the voting of their shares shall be valid and enforceable in accordance with their terms. Such agreements shall not be subject to the provisions of this section regarding voting trusts.

The last sentence is apparently designed to prevent the invalidation of otherwise valid (i.e., non-director-sterilizing) shareholder-level agreements. If, like Shakespeare's rose, they "smell" too much like voting trusts, they have been held invalid in the past for failure to comply with the filing, etc., requirements of the voting trust section.

If the only voting, then, is shareholder voting, a written side agreement can effectively provide for all aspects of the corporation's operation. In effect, a partnership can be created, with all the "partners" protected by limited liability. This is probably what was intended, and is, therefore, a reason for commendation of the new Model Act. It should be noted that, if this partnership corporation exists, it has been accomplished without the complex provisions of other statutes which have attempted to confer on small business a similar boon. The Act's only deficiency

38. See, e.g., Md. Ann. Code art. 23, § 105(a) (Supp. 1969) which states that: "A close corporation may, by its charter, provide that it will have no board of directors . . . ."
39. See, e.g., McQuade v. Stoneham, 263 N.Y. 323, 189 N.E. 234 (1934); Manson v. Curtis, 223 N.Y. 313, 119 N.E. 559 (1918). Model Act § 34, validating shareholders' agreements "regarding the voting of their shares," pointedly omits permission for such agreements to bind the signatories if voting as directors.
41. See, e.g., the number of sections necessary to accomplish this purpose in the close
is in not expressly validating such side agreements in those close corporations which choose to retain the board. 42

One carry-over by the Act (section 50 repeats old section 44) of an obstacle to flexible power allocation should also be noted. Section 50 seems clearly to require at least two persons to act as officers. Ironically then, although a one-man corporation need have only one director, or none, it must still have two officers. They may presumably be denied all express authority. However, even though the danger is limited, the dummy officer may cause problems because of his possible implied or apparent authority to bind the corporation. 44

IV. No “RED TAPE”

“Red tape” is generally anathema to close corporation participants. At least with respect to the organizational process, it is also anathema to attorneys for such corporations, since they are frequently general practitioners rather than corporate specialists, and, therefore, apt to be trapped by ignored technical requirements.

The old Model Act’s provision for reservation of a corporate name, widely enacted even by states which did not otherwise closely follow the Act, 45 was, of course, a great help. Before the provision was passed, the small practitioner without personal influence in the department of corporation portion of the Delaware statute. Del. Code Ann. tit. 8, §§ 342-44, 350-51, 354 (Supp. 1968).


43. Model Act § 50 provides that:

“The officers of a corporation shall consist of a president, one or more vice presidents as may be prescribed by the bylaws, a secretary, and a treasurer, each of whom shall be elected by the board of directors at such time and in such manner as may be prescribed by the by-laws. Such other officers and assistant officers and agents as may be deemed necessary may be elected or appointed by the board of directors or chosen in such other manner as may be prescribed by the by-laws. Any two or more offices may be held by the same person, except the offices of president and secretary.”

44. Another useful provision is found in Model Act § 33. It states that:

“Each outstanding share, regardless of class, shall be entitled to one vote on each matter submitted to a vote at a meeting of shareholders, except as may be otherwise provided in the articles of incorporation. If the articles of incorporation provide for more or less than one vote for any share, in any matter, every reference in this Act to a majority or other proportion of shares shall refer to such a majority or other proportion of votes entitled to be cast.”

Although different voting rights for otherwise identical shares will disqualify the corporation for Subchapter S tax treatment (Treas. Reg. § 1.1371-1(g), T.D. 6904, 1967-1 Cum. Bull. 219) such voting rights could be used to accomplish the disproportionate power structure on the shareholder level which the participants desired in Nicholopoulos v. Sarantis, 102 N.J. Eq. 585, 141 A. 792 (Ct. Err. & App. 1928).

state might well find that, although initially accepted, the corporate name he reserved had been preempted in the interim between clearance and receipt of the typed articles at the department. Statutorily recognized name reservation, as permitted by old section 8, did away with both the extra work of retyping and resubmitting new papers with a new, non-conflicting name, and the possible embarrassment of having to poll the clients on a substitute for the one originally chosen. It was, of course, reenacted in new Model Act section 9.

An old chore, looking up purpose clauses in form books, has wisely been eliminated in the new Act. The “all purpose” clause is now permitted. No longer, therefore, does a lawyer for a drug store need to specifically set forth as the corporate purposes a long list of activities ranging from the sale of snuff to the “manufacture” of pharmaceuticals and the operation of a restaurant to protect his clients from the possible charge of ultra vires. When old section 6, emasculating the ultra vires defense, was widely enacted, the policy decision against limiting corporate activities to those enumerated was, in effect, already made. It only remained to remove the last vestige of the philosophy of fear of corporateness by omitting the requirement of verbal commitment in the charter.

46. Model Act § 54 provides that:

“The articles of incorporation shall set forth:

(c) The purpose or purposes for which the corporation is organized which may be stated to be, or to include, the transaction of any or all lawful business for which corporations may be incorporated under this Act.”

47. The section was carried over (with minor stylistic changes in paragraph (a)) in Model Act § 7 which provides that:

“No act of a corporation and no conveyance or transfer of real or personal property to or by a corporation shall be invalid by reason of the fact that the corporation was without capacity or power to do such act or to make or receive such conveyance or transfer, but such lack of capacity or power may be asserted:

(a) In a proceeding by a shareholder against the corporation to enjoin the doing of any act or the transfer of real or personal property by or to the corporation. If the unauthorized act or transfer sought to be enjoined is being, or is to be, performed or made pursuant to a contract to which the corporation is a party, the court may, if all of the parties to the contract are parties to the proceeding and if it deems the same to be equitable, set aside and enjoin the performance of such contract, and in so doing may allow to the corporation or to the other parties to the contract, as the case may be, compensation for the loss or damage sustained by either of them which may result from the action of the court in setting aside and enjoining the performance of such contract, but anticipated profits to be derived from the performance of the contract shall not be awarded by the court as a loss or damage sustained.

(b) In a proceeding by the corporation, whether acting directly or through a receiver, trustee, or other legal representative, or through shareholders in a representative suit, against the incumbent or former officers or directors of the corporation.

(c) In a proceeding by the Attorney General, as provided in this Act, to dissolve the corporation, or in a proceeding by the Attorney General to enjoin the corporation from the transaction of unauthorized business.”

48. Limitations on permitted activities and the strict ultra vires rule were both facets of a repressive attitude toward corporations which characterized their early history in this country. This attitude was inspired by the fear of such bodies as the arms of what was
A desirable by-product of the new provisions is the probable saving of tax money which will result from diminishing the number of bureaucrats required to screen incorporation papers prior to official filing. There is also no real concomitant danger in permitting the clause, since, obviously, the articles’ filing will neither legalize an otherwise criminal activity (e.g., gambling) nor, for that matter, legalize any other activity prohibited to business corporations. In addition, although the articles’ form (old section 48) was already simple, with the new all-purpose clause, it will be even simpler.49

Simplicity of formation is also aided by the carry-over of the provision requiring only a single incorporator (old section 47, new section 53). Single filing, (old section 49, new section 55) “which is conclusive evidence” of due incorporation against all but the state in a direct action (old section 50, new section 56), is of valuable assistance because it means that once the lawyer receives the certificate that his corporation’s articles are filed he can forget about de facto problems.60


49. Model Act § 54 provides that:

"The articles of incorporation shall set forth:

(a) The name of the corporation.
(b) The period of duration, which may be perpetual.
(c) The purpose or purposes for which the corporation is organized which may be stated to be, or to include, the transaction of any or all lawful business for which corporations may be incorporated under this Act.
(d) The aggregate number of shares which the corporation shall have authority to issue; if such shares are to consist of one class only, the par value of each of such shares, or a statement that all of such shares are without par value; or, if such shares are to be divided into classes, the number of shares of each class, and a statement of the par value of the shares of each such class or that such shares are to be without par value.
(e) If the shares are to be divided into classes, the designation of each class and a statement of the preferences, limitations and relative rights in respect of the shares of each class.

(f) If the corporation is to issue the shares of any preferred or special class in series, then the designation of each series and a statement of the variations in the relative rights and preferences as between series as far as the same are to be fixed in the articles of incorporation, and a statement of any authority to be vested in the board of directors to establish series and fix and determine the variations in the relative rights and preferences as between series.

(g) If any preemptive right is to be granted to shareholders, the provisions therefor.
(h) Any provision, not inconsistent with law, which the incorporators elect to set forth in the articles of incorporation for the regulation of the internal affairs of the corporation, including any provision restricting the transfer of shares and any provision which under this Act is required or permitted to be set forth in the by-laws.
(i) The address of its initial registered office, and the name of its initial registered agent at such address.
(j) The number of directors constituting the initial board of directors and the names and addresses of the persons who are to serve as directors until the first annual meeting of shareholders or until their successors be elected and qualify.
(k) The name and address of each incorporator.

It shall not be necessary to set forth in the articles of incorporation any of the corporate powers enumerated in this Act."

50. See Robertson v. Levy, 197 A.2d 443 (D.C. Ct. App. 1964), which held specifically that the managers were individually liable under old Model Act § 139 (new Model Act
The "organization" of the corporation, principally the enactment of bylaws and the election of officers, can conceptually be allocated to the shareholders (for whom the incorporator is surrogate) or the directors.\textsuperscript{51} The Model Act, perhaps to be consistent with its provisions that bylaws are the ordinary province of the directors (old section 5, new section 27),\textsuperscript{52} requires that the directors complete the organization process. This, of course, necessitates that there be an initial director or directors to act. The Act, to insure that they are available to do this paper work, demands that the initial directors be named in the articles of incorporation.\textsuperscript{53} This choice seems unwise. It is one of the facts of corporate life that incorporators and initial directors are "dummies": the lawyer himself, or, where more than one person is needed, also his employees, or someone from down the hall. There is, of course, nothing to prevent the sole incorporator from also being sole, initial director. It does, however, mean repeating the name twice, an unnecessary technicality since the whole business is a fiction. In addition, it means that careful practitioners must undergo the ritual of having the initial director resign and elect his successor, a real director, after enactment of the bylaws and election of officers. This resignation will be a practical necessity if any other (real) business is to be transacted, e.g., the authorization of the issuance of shares, especially where they are in exchange for property

\footnote{\textsuperscript{51} For obligations incurred prior to the filing of the articles, but added that filing provided a cutoff date, thus, eliminating the necessity for de facto corporations and corporations by estoppel. Accordingly, there cannot be any individual liability as a result of defective organization unless the liability is incurred prior to filing. As to innocent nonfiling, the Robertson rule seems too harsh. See, e.g., Cranson v. International Business Mach. Corp., 234 Md. 477, 200 A.2d 33 (1964), where the court held the individual not liable when the nonfiling was due to the attorney's negligence, and the dealings were on a corporate basis. The Maryland statute does not contain a counterpart to Model Act § 146 (old Model Act § 139). Denial of a corporation's existence by estoppel, under such circumstances, would not seem mandated by the Model Act provision.}

\footnote{\textsuperscript{52} The possibility of analogous statutory liability for commencing business before the minimum paid-in capital requirements have been met (see old Model Act §§ 51, 43(c)) has wisely been eliminated from the new Act. A requirement of only $1,000 in the "till" gives such scant protection to creditors that it qualifies as mere "red tape," and, accordingly, its omission is a reason for commendation of the new Act.}

\footnote{\textsuperscript{53} The acceptance of share subscriptions also can be conceptually allocated to the shareholders or directors.}

\footnote{\textsuperscript{54} Most close corporations will not want the directors to have the power to amend the bylaws. Such corporations will prefer to give it to the shareholders. This will, under the Model Act § 27, require a specific provision in the articles. Since silence will confer power on the directors, the New York form (N.Y. Bus. Corp. Law § 601(a) (1963)), which represents the traditional position, is preferable. It leaves in the shareholders the power to enact bylaws unless the power is conferred upon the board by the certificate of incorporation or a shareholder bylaw provision.}

\footnote{\textsuperscript{55} Model Act § 54(j).}
which must be evaluated. It would have been much simpler, therefore, to confine organization to the incorporator who could then elect a real participant as director.

It is no longer necessary to worry about whether or not the signed minutes of a shareholder or director meeting will suffice even though no actual meeting has been held. The old Model Act allowed unanimous separate shareholder consent to substitute for an actual meeting (old section 138). This provision has, of course, been retained in the new Act (new section 145). Although the original Act did not include it, in 1966 an optional provision (Optional section 39A) was added to authorize directors also to take action without a meeting where all had signed a written consent “before such action.” This provision has now been made a regular part of the Act (section 44).

Obviously, such provisions help with the incorporation paperwork, since the attorney, acting as initial director, can sign the prefabricated record of the “action” to be taken at the organization “meeting.” Furthermore, the provision will be of even greater utility when the corporation is actually in operation, for the real participants can then forgo actual meetings as long as they memorialize their separately agreed decision in a signed record.

One problem with the original provision was that it expressly authorized only an advance consent and not one taken after the action. This could conceivably (on the well-recognized principle of construction of legislative intent, expressio unius est exclusio alterius) have been interpreted as denying validity to a written consent given after the action had occurred. New section 44 omits the requirement that the consent be signed “before such action,” and substitutes the words “action so taken”

54. The dummy director will not want to risk possible liability for significant decisions. See 47 Cornell L.Q. 443 (1962).


56. Model Act § 44 provides that:

"Unless otherwise provided by the articles of incorporation or by-laws, any action required by this Act to be taken at a meeting of the directors of a corporation, or any action which may be taken at a meeting of the directors or of a committee, may be taken without a meeting if a consent in writing, setting forth the action so taken, shall be signed by all of the directors, or all of the members of the committee, as the case may be. Such consent shall have the same effect as a unanimous vote."


57. Old Model Act Optional § 39A provided:

"Unless otherwise provided by the articles of incorporation or by-laws, any action required by this Act to be taken at a meeting of the directors of a corporation, or any act without a meeting if a consent in writing, setting forth the action so to be taken, shall be action which may be taken at a meeting of the directors or of a committee, may be taken signed before such action by all of the directors, or all of the members of the committee, as the case may be. Such consent shall have the same effect as a unanimous vote."
for old section 39A's language, action "to be taken." A consent after the action is now clearly permitted. Presumably, "action" is broad enough to include a decision to take action. It would certainly be strange if the prudent were penalized. Ironically, however, there is presently at least a scintilla of uncertainty as to the validity of advance consent. Perhaps, each director can sign a separate paper setting forth the agreed action. However, the use of the singular, "consent," might suggest that all had to sign the same paper. In any event, the language could easily have been corrected to avoid these uncertainties. 58

Another problem raised by statutory authorizations for written consent in lieu of a director's meeting also deserves mention. In the past, despite the general rule that absent a meeting, separate individual director consent, even if in writing, was ineffectual, 59 courts engrafted estoppel exceptions, even approving separate oral consent, 60 sometimes by less than all, 61 to uphold informally sanctioned transactions. The Act's express validation of only separate written consent might be interpreted as overruling these case law ameliorations of the stringent rule that directors must act at a regular meeting. Sometimes silence is better than not saying enough. Hopefully, however, this provision, obviously designed to be helpful and not a trap, will not be given such a restrictive interpretation. 62

"Unless otherwise provided by the certificate of incorporation or by-laws, any action required or permitted to be taken pursuant to authorization voted at a meeting of the board or any committee thereof, may be taken without a meeting if, prior or subsequent to such action, all members of the board or of such committee, as the case may be, consent thereto in writing and such written consents are filed with the minutes of the proceedings of the board or committee. Such consent shall have the same effect as a unanimous vote of the board or committee for all purposes, and may be stated as such in any certificate or other document filed with the Secretary of State."
59. See Baldwin v. Canfield, 26 Minn. 43, 1 N.W. 261 (1879). See also H. Henn, supra note 16, at 339.
62. The Model Act could easily have gone further. See, e.g., R.I. Gen. Laws § 7-1-1.39 (1969) which provides that, if authorized by the bylaws, meetings may be held by means of telephone conference circuit, and connection to such circuit constitutes presence at such a meeting. See also its predecessor, Pa. Stat. tit. 15, § 1008 (Supp. 1969); Kessler, supra note 37, at 718. Since both the North Carolina (N.C. Gen. Stat. § 55-29(a)(3) (1965)) and South Carolina (S.C. Code Ann. § 12-18.12 (Supp. 1968)) statutes generally recognize informal director action even though not pursuant to a written consent which is approved by the shareholders, they are advances over the Rhode Island and Pennsylvania statutes, and, undoubtedly, are improvements over the Model Act section.
V. RESOLVING DISPUTES

In a public issue corporation, although there may be some dissenters, and, perhaps, even a few "demonstrators," disputes are usually peacefully resolved by the vote of the "silent majority" of proxies. In a close corporation, however, disputes frequently rise to the "confrontation" level of tension. Obviously, some methods for resolving these disputes must be available. The standard ones are arbitration, buy-out, and, if all else fails, dissolution. Despite the fact that buy-out arrangements, whereby one side in a dispute forces the other to buy it out, or sell out to it, are presumably permissible because they involve share restrictions, the only leading method that the Model Act has expressly sanctioned is dissolution.63

While arbitration of disputes on the shareholder level may well be possible under the general permission for shareholder agreements,64 disputes among the participants in their director capacities, e.g., as to the election and removal of officers, and the day-to-day management of the corporation, would seem interdicted. This is true even where the state's arbitration statute is broad enough to include such disputes under the general rule which forbids outside interference with the powers confided by law to the board.65 A temporary delegation of director powers to arbitrators may be possible under a clause in the articles of incorporation permitting such a delegation.66 However, because the statute does not expressly authorize it, conservative secretaries of state may reject charters containing such arbitration provisions as not being "conformable to law." The Model Act's silence is in sharp contrast with at least one other statute, that of Florida, which not only permits arbitration, but also makes dissolution contingent upon its failure.67

63. Where the intramural conflict results in financial detriment to the corporation, frequently, receivership will also be available. See, e.g., N.J. Stat. Ann. 14A:14-2(2)(c) (1969) which allows an action for receivership by a shareholder owning at least ten percent of the outstanding shares of any class on the ground that: "the business of the corporation is being conducted at a great loss and greatly prejudicial to the interests of its creditors or shareholders."

Other remedies are available in a few jurisdictions. See, e.g., Cal. Corp. Code § 819 (Supp. 1970); Del. Code Ann. tit. 8, §§ 352, 353 (Supp. 1968); Mo. Rev. Stat. § 351.320 (1966) allowing the court to appoint a provisional director to break a deadlock; Del. Code Ann. tit. 8, § 352 (Supp. 1968) allowing appointment of a "custodian" if the shareholders or directors are deadlocked, or in lieu of dissolution under a certificate provision.

64. Model Act § 34.


66. Model Act § 35.

With regard to dissolution, the new Model Act in sections 83\(^{68}\) and 84\(^{69}\) incorporates both old section 76, which allows all the shareholders, by written consent, to dissolve the corporation, and old section 77,

> "The circuit court, sitting in chancery, may entertain a petition of any stockholder for involuntary dissolution of any close corporation and, at the hearing, may appoint a receiver or trustee of the corporation and order it dissolved, pursuant to the procedure provided in § 608.29, when it is made to appear:
> 1. That the directors of the corporation are deadlocked in the management of the corporate affairs and the stockholders are unable to break the deadlock, or
> 2. That the stockholders are deadlocked in voting power; and
> 3. Arbitration or any other remedy provided in any written agreement of the stockholders upon deadlock of the directors or stockholders has failed."

The Model Act § 4 even omits the possibly helpful corporate power to participate in arbitrage proceedings. See, e.g., N.Y. Bus. Corp. Law § 202(a)(2) (1963).

68. Model Act § 83 provides:

> "A corporation may be voluntarily dissolved by the written consent of all of its shareholders.

Upon the execution of such written consent, a statement of intent to dissolve shall be executed in duplicate by the corporation by its president or a vice president and by its secretary or an assistant secretary, and verified by one of the officers signing such statement, which statement shall set forth:

(a) The name of the corporation.
(b) The names and respective addresses of its officers.
(c) The names and respective addresses of its directors.
(d) A copy of the written consent signed by all shareholders of the corporation.
(e) A statement that such written consent has been signed by all shareholders of the corporation or signed in their names by their attorneys thereunto duly authorized."

69. Model Act § 84 provides:

> "A corporation may be dissolved by the act of the corporation, when authorized in the following manner:

(a) The board of directors shall adopt a resolution recommending that the corporation be dissolved, and directing that the question of such dissolution be submitted to a vote at a meeting of shareholders, which may be either an annual or a special meeting.
(b) Written notice shall be given to each shareholder of record entitled to vote at such meeting within the time and in the manner provided in this Act for the giving of notice of meetings of shareholders, and, whether the meeting be an annual or special meeting, shall state that the purpose, or one of the purposes, of such meeting is to consider the advisability of dissolving the corporation.
(c) At such meeting a vote of shareholders entitled to vote thereat shall be taken on a resolution to dissolve the corporation. Such resolution shall be adopted upon receiving the affirmative vote of the holders of a majority of the shares of the corporation entitled to vote thereon, unless any class of shares is entitled to vote thereon as a class, in which event the resolution shall be adopted upon receiving the affirmative vote of the holders of a majority of the shares of each class of shares entitled to vote thereon as a class and of the total shares entitled to vote thereon.
(d) Upon the adoption of such resolution, a statement of intent to dissolve shall be executed in duplicate by the corporation by its president or a vice president and by its secretary or an assistant secretary, and verified by one of the officers signing such statement, which statement shall set forth:

(1) The name of the corporation.
(2) The names and respective addresses of its officers.
(3) The names and respective addresses of its directors.
(4) A copy of the resolution adopted by the shareholders authorizing the dissolution of the corporation.
(5) The number of shares outstanding, and, if the shares of any class are entitled to vote as a class, the designation and number of outstanding shares of each such class.
(6) The number of shares voted for and against the resolution, respectively, and, if the shares of any class are entitled to vote as a class, the number of shares of each such class voted for and against the resolution, respectively."
which provides, with minor changes (including reduction of the required shareholder vote from two-thirds to a majority) for dissolution upon the directors’ recommendation and shareholders’ approval at a meeting. Obviously, section 83 is only of use in a conflict situation where, despite their disagreements, the shareholders are all able to agree on this one crucial matter, an unlikely occurrence. In a close corporation, most significant decisions will ordinarily be subject to a minority veto (by use of a high vote requirement on director and/or shareholder levels). Accordingly, section 84 will usually not be available as a device for breaking a deadlock, and, in fact, may be subject to one.

Since the Model Act, unlike a number of recent statutes, does not authorize a provision in the articles whereby the participants can provide in advance for the circumstances under which a participant can automatically dissolve the corporation, principal reliance under the Act will have to be placed on judicial dissolution. Section 97 of the Model Act reenacts old section 90. If a shareholder sues, it allows, but does not mandate, judicial “liquidation of the assets and business of a corporation,” on any one of four grounds:

1. That the directors are deadlocked in the management of the corporate affairs and the shareholders are unable to break the deadlock, and that irreparable injury to the corporation is being suffered or is threatened by reason thereof; or

2. That the acts of the directors or those in control of the corporation are illegal, oppressive or fraudulent; or

3. That the shareholders are deadlocked in voting power, and have failed, for a period which includes at least two consecutive annual meeting dates, to elect successors to directors whose terms have expired or would have expired upon the election of their successors; or

4. That the corporate assets are being misapplied or wasted.

Obviously, the availability of the fourth ground in an intra-corporate conflict situation will be limited. The utility of ground two will depend on how far the courts stretch the meaning of “illegal, oppressive or fraudulent.” Not only is the first ground dependent on a showing of “irreparably injury,” but, although obviously designed for close corporations, it is only usable by shareholders in those corporations which have a veto requirement for director action or an even number of directors. The third ground is certain, but, of course, requires a two year wait.

70. Model Act §§ 32, 40.
72. Under Model Act § 39, if the directors are removable by a majority of the shareholders, dissolution will not be available since the deadlock can be broken.
73. Mass. Gen. Laws ch. 156B, § 99 (1970) no longer requires the two year wait for a petition on this ground. It should be noted that permission to file a petition for dissolu-
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The explicit means offered by the new Model Act for the resolution of intra-corporate disputes in the close corporations are the same as those offered by the old Act, and, accordingly, lag behind more modern developments in other statutes.

VI. MISCELLANEOUS PROVISIONS

Section 38 of the 1969 Act repeats old section 36, which provides for the filling of director vacancies by a majority of the remaining directors. The only deficiency here is that the statute does not allow the articles to provide otherwise. The result may be a control shift, disastrous to a carefully planned close corporate set-up. The only secure protection would seem to be to abolish the board.

Unlike a number of other recent statutes, the Model Act contains no express authorization for election of officers by the shareholders rather than the board. Under the Act officers are also only removable by the board. Presumably, if the articles contain a provision confiding these aspects of director power to the shareholders, they will prevail. However, the new Act’s language might have been explicit. Although unlikely, it

is not a guarantee that dissolution will be granted. The classic example is In re Radom & Neldorff, Inc., 307 N.Y. 1, 119 N.E.2d 563 (1954).


76. Model Act § 50 provides that:

“The officers of a corporation shall consist of a president, one or more vice presidents as may be prescribed by the by-laws, a secretary, and a treasurer, each of whom shall be elected by the board of directors at such time and in such manner as may be prescribed by the by-laws. Such other officers and assistant officers and agents as may be deemed necessary may be elected or appointed by the board of directors or chosen in such other manner as may be prescribed by the by-laws. Any two or more offices may be held by the same person, except the offices of president and secretary.

All officers and agents of the corporation, as between themselves and the corporation, shall have such authority and perform such duties in the management of the corporation as may be provided in the by-laws, or as may be determined by resolution of the board of directors not inconsistent with the by-laws.”

77. Model Act § 51 provides that:

“Any officer or agent may be removed by the board of directors whenever in its judgment the best interests of the corporation will be served thereby, but such removal shall be without prejudice to the contract rights, if any, of the person so removed. Election or appointment of an officer or agent shall not of itself create contract rights.”

78. See, e.g., N.Y. Bus. Corp. Law § 715(b) (1963): “The certificate of incorporation may provide that all officers or that specified officers shall be elected by the shareholders instead of by the board.” The even simpler New Jersey provision, coupled with deletion of the words “by the board of directors” and “in its judgment” from the Model Act (Model Act § 50), could also easily have been used to accommodate the close corporation’s needs. N.J.
is always possible that the election and removal of officers will not be considered a management function, and hence, not delegable. If so, such election and removal will remain a director function, and typical shareholder agreements which provide for election of named signatories as officers may well be invalid. This, of course, is no help to the close corporation. If the Committee wanted to insure the validity of such agreements, as it probably did, it should have made it clear that a corporation could provide for shareholder election and removal of officers through a charter or bylaw provision. This would have “downgraded” such otherwise director-impinging contracts to the shareholder level, where, under section 34, they would have been clearly valid.

Another matter deserves mention. Preemptive rights, or the privilege of preserving one’s power-financial participation in a corporation when new shares are issued, are valuable to close corporation participants. They are, of course, not a guarantee against a freeze-out; but a freeze-out of a minority holder through issuance of new shares is much easier without them.

The Model Act has two alternative provisions with regard to preemptive rights, and so like a Chinese menu, a state can choose one from column A or one from column B. Unless the charter provides otherwise, the first, section 26, denies preemptive rights completely, while the second, section 26A, with exceptions, grants them.

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79. The leading case is McQuade v. Stoneham, 263 N.Y. 323, 189 N.E. 234 (1934).

80. See text accompanying notes 39-40 supra.


82. Model Act § 26 provides that:

“The shareholders of a corporation shall have no preemptive right to acquire unissued or treasury shares of the corporation, or securities of the corporation convertible into or carrying a right to subscribe to or acquire shares, except to the extent, if any, that such right is provided in the articles of incorporation.”

83. Model Act § 26A provides that:

“Except to the extent limited or denied by this section or by the articles of incorporation, shareholders shall have a preemptive right to acquire unissued or treasury shares or securities convertible into such shares or carrying a right to subscribe to or acquire shares.

Unless otherwise provided in the articles of incorporation,

(a) No preemptive right shall exist:

(1) to acquire any shares issued to directors, officers or employees pursuant to approval by the affirmative vote of the holders of a majority of the shares entitled to vote thereon or when authorized by and consistent with a plan theretofore approved by such a vote of shareholders; or

(2) to acquire any shares sold otherwise than for cash.

(b) Holders of shares of any class that is preferred or limited as to dividends or assets shall not be entitled to any preemptive right.

(c) Holders of shares of common stock shall not be entitled to any preemptive right to shares of any class that is preferred or limited as to dividends or assets or to any obligations, unless convertible into shares of common stock or carrying a right to subscribe to or acquire shares of common stock.

(d) Holders of common stock without voting power shall have no preemptive right to shares of common stock with voting power.
Public issue corporations, with good reason, do not like preemptive rights, because they obligate the corporation to solicit, perhaps, many thousands of shareholders before a new offering to the public can be made. In the public issue corporation's case, therefore, the granting of preemptive rights seems completely unnecessary, since any present shareholders can always preserve their proportionate participation by the simple expedient of buying the new shares on the open securities markets. To make it easier for public issue corporations, most states will probably enact section 26 rather than section 26A. This is not fatal to close corporations. It means, however, that the less sophisticated close corporation lawyer must remember to make the necessary addition to the charter so that the preemptive rights will be granted.

A rather dangerous provision (old section 71) has remained substantially intact in the new Act (section 78), and may pose dangers to close corporations. It allows the directors to mortgage or pledge all of the corporation's assets even though not in the usual and regular course of the corporation's business. Obviously, since a mortgage can always be foreclosed, this power poses a danger to minority interests. Moreover, this power is not one which the statute expressly authorizes a corporation to negate by a contrary charter provision requiring shareholder approval. It is possible, therefore, that the only way to protect the shareholders may be to require a high director vote to mortgage corporate assets. This will, of course, be no help to a minority shareholder not represented on the board, and suggests the wisdom of adding “unless otherwise provided in the articles of incorporation . . . ” to such statutory grants of directorial power.

VII. CONCLUSION

What then should be the final evaluation of the new revision? As indicated, the new revision has added only a few provisions to assist the close

(e) The preemptive right shall be only an opportunity to acquire shares or other securities under such terms and conditions as the board of directors may fix for the purpose of providing a fair and reasonable opportunity for the exercise of such right."


85. Model Act § 78 provides:

"The sale, lease, exchange, or other disposition of all, or substantially all, the property and assets of a corporation in the usual and regular course of its business and the mortgage or pledge of any or all property and assets of a corporation whether or not in the usual and regular course of business may be made upon such terms and conditions and for such consideration, which may consist in whole or in part of cash or other property, including shares, obligations or other securities of any other corporation, domestic or foreign, as shall be authorized by its board of directors; and in any such case no authorization or consent of the shareholders shall be required."

86. This raises the question of whether a provision under Model Act § 54 could be used to require shareholder approval as well.

corporation. There are no new provisions for resolving disputes, and this is disappointing.

The one subdivision designed to accommodate the need to keep the close corporation close seems supererogatory because of its failure to specify and expressly validate particular forms of share restrictions.

Except for the minor change in the director-consent provision, the only change in the Model Act subserving the no-"red-tape" demand is the authorization of the all purpose clause. This clause is, however, sufficient reason for commendation, although the simplification could have gone further.

The most significant changes introduced by the new Act are in the area of flexibility of power allocation. Section 34, with regard to shareholder agreements, is not radical, since, taken alone, it merely codifies the common law rule.

Section 35, allowing the abolition of the board of directors as a management organ, and section 36, providing the corporation with the power to choose any number of directors it desires, are, of course, significant advances. These provisions will enable a close corporation with any number of participants to mold the control power given to each person in terms of financial or opposing nonfinancial considerations exactly as the participants agree. In any vote on the new Act's merits these sections must weigh heavily in its favor.

All improvements are, of course, to be measured against deficiencies carried over from the previous version. Each legislature must make this evaluation for itself. It is safe to say, however, that the new Model Act is more favorable to the close corporation than its predecessor. It is also safe to say that it could have been more favorable.

88. See also, however, the abolition of the minimum capital requirement, old Model Act §§ 51, 43(e).