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Cover Page Footnote

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A CLOSE CORPORATION CHECKLIST FOR DRAFTING THE CERTIFICATE OF INCORPORATION UNDER THE NEW YORK BUSINESS CORPORATION LAW

ROBERT A. KESSLER*

I. INTRODUCTION

A GREAT deal has been written about the "close corporation," its problems under corporation statutes designed more appropriately for public issue corporations, and ways of fulfilling the desires of close-corporate participants by twisting the statutory pattern to fit their peculiar needs.¹ This article will not reconsider all that has gone before,

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1. See, e.g., O'Neal, *Close Corporations* (1958); O'Neal & Derwin, *Expulsion or Oppression of Business Associates: "Squeeze-Outs" in Small Enterprises* (1961); Rohrlich, *Organizing Corporate and Other Business Enterprises* §§ 4.19-28 (3d ed. 1958); Seward, *Basic Corporate Practice* 54-64 (1960); Ballard, *Arrangements for Participation in Corporate Management Under the Pennsylvania Business Corporation Law*, 25 *Temp. L.Q.* 131 (1951); Burstein, *The Dissolution of Closed Corporations*, 123 *N.Y.L.J.* 1464, 1484, 1504 (1950); Cary, *How Illinois Corporations May Enjoy Partnership Advantages: Planning for the Closely Held Firm*, 48 *Nw. U.L. Rev.* 427 (1953); Cataldo, *Limited Liability with One-Man Companies and Subsidiary Corporations*, 18 *Law & Contemp. Prob.* 473 (1953); Cataldo, *Stock Transfer Restrictions and the Closed Corporation*, 37 *Va. L. Rev.* 229 (1951); Chayes, *Madame Wagner and the Close Corporation*, 73 *Harv. L. Rev.* 1532 (1960); Delaney, *The Corporate Director: Can His Hands Be Tied in Advance*, 50 *Colum. L. Rev.* 52 (1950); Fleming, *Desirability of Enacting Separate Statutes for Closely Held and Publicly Owned Corporations*, *N.Y. Leg. Doc. No. 17* (1957); Fuller, *The Incorporated Individual: A Study of the One-Man Company*, 51 *Harv. L. Rev.* 1373 (1938); Gower, *The English Private Company*, 18 *Law & Contemp. Prob.* 535 (1953); Hayes, *Corporation Cake With Partnership Frosting*, 40 *Iowa L. Rev.* 157 (1954); Hoffman, *New Horizons for the Close Corporation in New York Under Its New Business Corporation Law*, 23 *Brooklyn L. Rev.* 1 (1961); Hornstein, *Controversies Under Stockholders' Agreements*, 5 *Arb. J. (n.s.)* 62 (1950); Hornstein, *Judicial Tolerance of the Incorporated Partnership*, 18 *Law & Contemp. Prob.* 435 (1953); Hornstein, *Stockholders' Agreements in the Closely Held Corporation*, 59 *Yale L.J.* 1040 (1950); Israels, *The Close Corporation and the Law*, 33 *Cornell L.Q.* 488 (1948); Israels, *The Sacred Cow of Corporate Existences*, 19 *U. Chi. L. Rev.* 778 (1952); Kessler, *The New York Business Corporation Law*, 36 *St. John's L. Rev.* 1, 42-67 (1961); Kessler, *The Statutory Requirement of a Board of Directors: A Corporate Anachronism*, 27 *U. Chi. L. Rev.* 696 (1960); Latty, *The Aggrieved Buyer or Seller or Holder of Shares in a Close Corporation Under the S.E.C. Statutes*, 18 *Law & Contemp. Prob.* 505 (1953); Latty, *The Close Corporation and the New North Carolina Business Corporation Act*, 34 *N.C.L. Rev.* 432 (1956); Lyon, *Federal Income Taxation, 1958 Ann. Survey Am. L.* 269; Meck, *Employment of Corporate Executives by Majority Stockholders*, 47 *Yale L.J.* 1079 (1938); O'Neal, *Arbitration in Close Corporations: A Study in Legislative Needs*, 12 *Arb. J. (n.s.)* 191 (1957); O'Neal, *Arrangements Which Protect Minority Shareholders Against "Squeeze-Outs"*, 45 *Minn. L. Rev.* 537 (1961); O'Neal, *Giving Shareholders Power to Veto Corporate Decisions: Use of Special Charter and By-Law Provisions*, 18 *Law & Contemp. Prob.* 451 (1953); O'Neal, *Molding the Corporate Form to Particular Business Situations: Optional*

but will, instead, presume that the reader is generally familiar with the literature and problems of close corporations and desires some guide to the application of his knowledge to the specific problem of drafting the appropriate papers for a close corporation under the new New York Business Corporation Law.²

Charter Clauses, 10 Vand. L. Rev. 1 (1956); O'Neal, Oppugnancy and Oppression in Close Corporations: Remedies in America and in Britain, 1 Boston College Ind. & Com. L. Rev. 1 (1959); O'Neal, Protecting Shareholders' Control Agreements Against Attack, 14 Bus. Law. 184 (1958); O'Neal, Recent Legislation Affecting Close Corporations, 23 Law & Contemp. Prob. 341 (1958); O'Neal, Resolving Disputes in Closely Held Corporations: Intra-Institutional Arbitration, 67 Harv. L. Rev. 786 (1954); O'Neal, Restrictions on Transfer of Stock in Closely Held Corporations: Planning and Drafting, 65 Harv. L. Rev. 773 (1952); Peril, The Uses of Pension and Profit-Sharing Plans for Small or Medium-Sized Businesses, 66 Dick. L. Rev. 143 (1962); Plate, Oppression as a Basis for Dissolving a Solvent Corporation, 30 U. Cinn. L. Rev. 478 (1961); Rice, The Valuation of Close Held Stocks: A Lottery in Federal Taxation, 98 U. Pa. L. Rev. 367 (1950); Robinson, Shareholders' Agreements and The Statutory Norm, 43 Cornell L.Q. 68 (1957); Rohrlch, Legal Problems in the Organization and Structure of a Close Business Corporation, 124 N.Y.L.J. 266, 274 (1950); Specter, Pension and Profit Sharing Plans: Coverage and Operation for Closely Held Corporations and Professional Associations, 7 Vill. L. Rev. 335 (1962); Strecker, Corporate Buy-Sell Agreements: Tax Problems in Drafting, 15 Wash. & Lee L. Rev. 18 (1958); Treillard, The Close Corporation in French and Continental Law, 18 Law & Contemp. Prob. 546 (1953); Weiner, Legislative Recognition of the Close Corporation, 27 Mich. L. Rev. 273 (1929); Winer, Proposing a New York "Close Corporation Law," 28 Cornell L.Q. 313 (1943); Symposium: New York Business Corporation Law, 11 Buffalo L. Rev. 429 (1962); Symposium, 18 Law & Contemp. Prob. 433 (1953); Symposium—The Close Corporation, 52 Nw. U.L. Rev. 345 (1957); The Use of Life Insurance to Fund Agreements Providing for Disposition of a Business Interest at Death, 71 Harv. L. Rev. 687 (1958); A Plea for Separate Statutory Treatment of the Close Corporation, 33 N.Y.U.L. Rev. 700 (1958). See also Henn, Corporations and Other Business Enterprises 401-47 (1961); Hornstein, Corporation Law and Practice (1959).

2. Hereinafter referred to in text as B.C.L. The New York Business Corporation Law has already been the subject of extensive law review comment. See Anderson & Leshner, The New Business Corporation Law, 33 N.Y.S.B.J. 308, 428 (1961); de Capriles & McAniff, The Financial Provisions of the New (1961) New York Business Corporation Law, 36 N.Y.U.L. Rev. 1239 (1961); Fuld, New York's New Business Corporation Law, 19 N.Y. County Lawyers Ass'n B. Bull. 52 (1961); Hoffman, New Horizons for the Close Corporation in New York Under Its New Business Corporation Law, 28 Brooklyn L. Rev. 1 (1961); Kessler, The New York Business Corporation Law, 36 St. John's L. Rev. 1 (1961); Simon & Davis, The New York Business Corporation Law and the Department of State, 36 St. John's L. Rev. 205 (1962); Stevens, New York Business Corporation Law of 1961, 47 Cornell L.Q. 141 (1962); Symposium: New York Business Corporation Law, 11 Buffalo L. Rev. 429 (1962), containing the following articles: Leshner, Introduction to Symposium on New York Business Corporation Law, *id.* at 429; Henn, The Philosophies of the New York Business Corporation Law of 1961, *id.* at 439; de Capriles, New York Business Corporation Law: Article 5—Corporate Finance, *id.* at 461; Stevens, Close Corporations and the New York Business Corporation Law of 1961, *id.* at 481; Hoffman, The Status of Shareholders and Directors Under New York's Business Corporation Law: A Comparative View, *id.* at 496; Latty, Some General Observations on the New Business Corporation Law of New York,

This work will, then, as its title implies, do little more than list possible subjects (with a brief comment on each) which the experienced practitioner may (or may not) decide should be covered in the certificate of incorporation of his close New York corporation. The specific form which provisions on these matters should take will not be set forth verbatim for two reasons: first, every close corporation is an individual, and like an individual person, may wear ready-made "clothes," but will look better in custom-made ones, or at least ones that are "cut to measure," and hence, forms for various provisions are really dangerous since the tendency is to copy them all with raffish results, while the task of "piecing" the needed provisions is often more difficult than the actual drafting of a whole set of certificate provisions to meet the specific needs of the client; and, second, for those who want the aid of suggested forms, and are willing to make the necessary modifications which any form entails, a number are already available, if not from practice under the present law, then from numerous other sources.³ This article will, therefore, merely pinpoint the areas in which the close-corporation practitioner may want to consider drafting or modifying a ready-made form to cover the matter.

Participants in a close corporation ordinarily have two main demands: (1) A proper share of the profits (equal or unequal as the individual situation may dictate); (2) A proper voice in the management (also equal or unequal as the clients' wishes dictate). An obvious method of providing for the first is through the terms of stock ownership; while

id. at 591. In addition, a number of student comments on various facets of the new law have appeared: Article V of the New York Business Corporation Law: Corporate Finance, 13 Syracuse L. Rev. 93 (1961); Corporations: Domestic Regulation of Foreign Corporations: Concept of "Domiciled Foreign Corporation": New York Business Corporation Law of 1961, 47 Cornell L.Q. 263 (1962); Particular Problems Under the New York Business Corporation Law, 11 Buffalo L. Rev. 615 (1962); Section 1312 of the Business Corporation Law: The Dilemma of Legislative History and Judicial Interpretation, 30 Fordham L. Rev. 331 (1961); Shareholder Liability for Wages: Section 630 of the New York Business Corporation Law, 30 Fordham L. Rev. 471 (1962). There were a number of Bar Association Reports. See, e.g., Report on New York Business Corporation Law, Committee on Corporation Law, 33 N.Y.S.B.J. 435 (1961). A list of official materials is found in Henn, The Philosophies of the New York Business Corporation Law of 1961, 11 Buffalo L. Rev. 439, 440-41 nn.11 & 12 (1962). Caveat: A number of the above were written before the most recent amendments. The 1962 amendments are summarized in Rohrllich, The Business Corporation Law—1962 Amendments, 148 N.Y.L.J. No. 25, at 4 (Aug. 6, 1962). An excellent and up-to-date (including the 1962 amendments) analysis of the new law by Professor Hornstein appears in McKinney's N.Y. Bus. Corp. Law, Appendix 2 (reprinted from 2 Hornstein, Corporation Law and Practice (Supp. 1962)).

3. See, e.g., *Israels & Gorman, Corporate Practice (P.L.I. 1957)*; 2 *O'Neal, Close Corporations 238-334 (1958)*; *Fletcher, Corporation Forms Annotated (3d ed. 1957)*; 3 & 4 *Am. Jur. Legal Forms, Corporations (1953) (Supp. 1961)*.

the second may be easily accomplished through manipulation of the management structure in the corporation (so far as that is legally possible).

Unfortunately for neat conceptualism, the two categories often overlap: The "proper share" is often taken in the form of salaries as an officer or employee rather than through dividends. This necessitates a management structure which will guarantee continued employment. Thus, management structure provisions overlap share of profit provisions. Stock provisions also carry management power because of the particular voting (or nonvoting) rights attendant upon the various stock classes and hybrids chosen. Provisions determining the share of profits, therefore, inevitably overlap management structure provisions. Solely because some organization seems necessary, then, and with the caveat that a provision from one category may well affect a provision from another, the first two divisions of the checklist will be divided between "stock or share provisions,"⁴ and "management structure" suggestions.

It is also universally recognized that the more effective the management structure is in giving appropriate voice to the demands of the close-corporate participants, the more likely "deadlocks" are to arise. Provisions are, therefore, necessary to deal with such situations. Methods of solving deadlock problems will, accordingly, form the third segment of the checklist.

Since it is almost always true that some phenomena fall outside of recognized concepts, there usually must be a "miscellaneous" category in which to lump them, hence, an "additional provisions" segment.

II. GENERAL OBSERVATIONS

The new B.C.L. attempts to liberalize the New York law in regard to close corporations. The principal section designed to do this is section 620.⁵ In the statute as originally enacted, this provision was one

4. This includes share dispositions when participants die, desire to leave the business or retire. Such provisions are, of course, necessary to subserve both the ends of "proper share" and "proper say."

5. N.Y. Bus. Corp. Law § 620 provides: "(a) An agreement between two or more shareholders, if in writing and signed by the parties thereto, may provide that in exercising any voting rights, the shares held by them shall be voted as therein provided, or as they may agree, or as determined in accordance with a procedure agreed upon by them. (b) A provision in the certificate of incorporation otherwise prohibited by law as improperly restrictive of the discretion or powers of the directors in their management of corporate affairs as provided in this chapter shall nevertheless be valid: (1) If all the incorporators or holders of record of all outstanding shares, whether or not having voting power, have authorized such provision in the certificate of incorporation or an amendment thereof; and (2) If,

of the most poorly drafted portions of the entire law. An amendment this year, however, has clarified it considerably. Nevertheless, there is still an automatic termination of the benefits of section 620(b)—provisions otherwise “improperly restrictive of the discretion or powers of the directors”—not only whenever the corporation goes public, but also whenever shares are transferred or issued to persons who do not have “knowledge or notice” of such provisions, unless they consent in writing to be bound by them. The amendment requires that notice of such provisions be contained on each certificate of stock,⁶ but it does not expressly make such notice sufficient to defeat the automatic termination which will otherwise result from a transfer to persons without “knowledge or notice.” Of course, properly interpreted, the statute will never invalidate such close-corporation provisions where the corporation has issued all of its stock certificates with a reference to the provisions contained on them.⁷ However, the statute is new, and quite radical. There is no guarantee that it will be properly interpreted,⁸ and it does not, as it

subsequent to the adoption of such provision, shares are transferred or issued only to persons who had knowledge or notice thereof or consented in writing to such provision. (c) A provision authorized by paragraph (b) shall be valid only so long as the shares of the corporation are not traded on a national securities exchange or regularly traded in an over-the-counter market by one or more members of a national or affiliated securities association. (d) An amendment to strike out a provision authorized by paragraph (b) shall be authorized at a meeting of shareholders by vote of the holders of two-thirds of all outstanding shares entitled to vote thereon or by the holders of such greater proportion of shares as may be required by the certificate of incorporation for that purpose. (e) The effect of any such provision authorized by paragraph (b) shall be to relieve the directors and impede upon the shareholders consenting thereto the liability for managerial acts or omissions that is imposed on directors by this chapter to the extent that and so long as the discretion or powers of the directors in their management of corporate affairs is controlled by any such provision. (f) If the certificate of incorporation of any corporation contains a provision authorized by paragraph (b), notice of the existence of such provision shall appear plainly on the face or back of every certificate for shares issued by such corporation.”

6. N.Y. Bus. Corp. Law § 620(f).

7. Transfer of legal title to shares of stock, according to N.Y. Pers. Prop. Law § 162 (Uniform Stock Transfer Act § 1), requires transfer of the certificate. Hence, in the ordinary case it should be difficult to deny knowledge when the notice appears on the stock certificate as the statute requires. However, there are apparently possibilities of a person being a shareholder without any certificates ever having been issued to him (see *Gale-Hasslacher Corp. v. Carmen Contracting Corp.*, 219 N.Y.S.2d 212 (Sup. Ct. 1961)), and certainly equitable ownership of shares is possible. The Uniform Commercial Code, effective Sept. 27, 1964, seems to increase the possibilities of a transfer of shares without delivery of the certificate. See Uniform Commercial Code §§ 8-313, 8-320.

8. Compare, e.g., Dean Stevens' intimation that the new law may allow a corporation to abolish the board completely (Stevens, *Close Corporations and the New York Business Corporation Law of 1961*, 11 Buffalo L. Rev. 481, 490 (1962)), with Anderson and Lecher's statement that “The new Business Corporation Law was drafted upon the basic philosophy

easily could have, make the certificate legend conclusive proof of "knowledge" by the transferee. Until such time as the statute is again amended to do this, wise practitioners will not place their sole reliance on this section when planning their close-corporate setup. Furthermore, any provisions which are only sanctioned by section 620(b) should also be carefully separated in the certificate from provisions which are necessary to successful close-corporate operation, but which are lawful without resort to section 620(b). Thus, if the section 620(b) provisions fall as a result of transfer of shares to a nonconsenting shareholder without "knowledge or notice," the desired system of operation can still be maintained. The aim, therefore, is to insure the desired financial and management structure even without resort to section 620(b) provisions, which should, at best, be "additional provisions," carefully labelled to insure that they are the only ones susceptible of such automatic termination. Provisions likely to be held within the scope of section 620(b) will, therefore, be placed under the "additional provisions" portion of the checklist. It is disappointing for close-corporation law practitioners to realize that all the old case law on permissible deviations from "statutory norms" may still survive when courts are faced with the problem of determining whether or not such a close-corporation arrangement has automatically terminated.

In addition to the first general observation that many provisions which would not be valid under present law should be avoided, or, if not omitted, should be separately treated to avoid invalidation of the entire planned setup, another and less distressing general observation should be made. The new law, unlike the present statutes, expressly provides that the certificate of incorporation may contain any provision which the law states is a proper subject for inclusion in the bylaws.⁹ Wise practitioners, of course, want to include all necessary close-corporation pro-

of a strong board of directors." Anderson & Leshner, *The New Business Corporation Law*, 33 N.Y.S.B.J. 308, 428 (1961). Dean Stevens was Chief Consultant to the Joint Legislative Committee which drafted the statute, while Sen. Warren M. Anderson was Chairman of the Committee and Robert S. Leshner was Counsel to the Committee. Even properly interpreted, of course, § 620 will not give a carte blanche to every close-corporate arrangement. See Kessler, *The New York Business Corporation Law*, 36 St. John's L. Rev. 1, 42-55 (1961). Unquestionably, such extra-parametral arrangements as that in *Nickolopoulos v. Sarantis*, 102 N.J. Eq. 585, 141 Atl. 792 (Ct. Err. & App. 1928) are not validated. A further disadvantage of N.Y. Bus. Corp. Law § 620(b) provisions is that they impose directorial liability upon all "shareholders consenting thereto." N.Y. Bus. Corp. Law § 620(e). (Quaere: Who are consenting shareholders when the § 620(b) provisions are in the certificate of incorporation?) Perhaps even inactive shareholders will be held liable. See *Recent Legislation: Corporations—In General—New York Statute Gives Special Treatment to Close Corporations—N.Y. Laws 1961, ch. 855, 75 Harv. L. Rev. 852, 854 (1962).*

9. N.Y. Bus. Corp. Law § 402(b).

visions in all three documents which they draw for their clients: the shareholder's agreement¹⁰ preceding the actual incorporation, the certificate of incorporation and the bylaws. The placing of the provisions in the certificate will presumably (except for section 620(b) provisions)¹¹ require the same percentage for removal as any other certificate amendment, an obvious advantage to the structural stability of the close corporation because of the attendant difficulty of approval and one which may not be obtainable with regard to bylaws unless there is a provision for unanimous director action.¹² Thus, all of the provisions, which are discussed *infra*, are proper subjects for inclusion in the certificate, and, of course, should also be contained in the prior shareholder agreement and the subsequent bylaws.

Before discussing specific certificate provisions, it also should be observed that most will be unnecessary for the one-man corporation under the new law. The principal problem with the one-man corporation in the past has been due to the necessity for two dummies to fill the statutory requirement of a three-man board of directors. But Pinocchio was not the only dummy who ever came to life. The problem, of course, was by careful draftsmanship to keep these superfluous directors from causing trouble. This will no longer be necessary since the dummies may be eliminated. New York, following Delaware's lead,¹³ amended the B.C.L. to allow a one-director board in one-man corporations.¹⁴ Where there is to be only one stockholder, then, the corporate practitioner can forget about his drafting problems, and collect his

10. See *Fromkin v. Merrill Realty, Inc.*, 30 Misc. 2d 288, 215 N.Y.S.2d 525 (Sup. Ct. 1961), *aff'd*, 15 App. Div. 2d 919, 225 N.Y.S.2d 632 (2d Dep't 1962).

11. N.Y. Bus. Corp. Law § 620(d) requires approval by two-thirds of all outstanding shares entitled to vote thereon to strike out a § 620(b) provision or such greater vote as is required by the certificate of incorporation for that purpose under N.Y. Bus. Corp. Law § 616. As indicated above, however, the provisions automatically terminate once one share is transferred or issued to a nonconsenting person unless he had "knowledge or notice." Obviously, where § 620(b) provisions are relied upon, the number of authorized shares must be carefully limited to prevent the board from issuing shares to outsiders, and restrictions on share transfers must be carefully drafted. Note, however, that an absolute prohibition on transfer will probably be void. *Allen v. Biltmore Tissue Corp.*, 2 N.Y.2d 534, 141 N.E.2d 812, 161 N.Y.S.2d 418 (1957). So far as possible, it should be guaranteed that every certificate for shares will bear a sufficient notice of the § 620(b) provisions.

12. It should also be noted that for changes in the bylaws only approval of shareholders entitled to vote in the election of directors is required. N.Y. Bus. Corp. Law § 601. It is simpler to place all necessary close-corporate provisions in the certificate where blanket approval of all shareholders can be required, if so desired. N.Y. Bus. Corp. Law §§ 803(c), 616(a)(2).

13. Del. Sess. Laws 1961, ch. 171.

14. N.Y. Bus. Corp. Law § 702(a).

fee with little difficulty.¹⁵ The client must be warned, however, to consult his attorney before selling any of his stock or issuing any new stock.¹⁶

The statute also allows a two-stockholder corporation to have a two-director board.¹⁷ If both financial and control interests are to be equal, most drafting problems will be alleviated.¹⁸ Wherever, on the other hand, either control or profit participation are to be unequal, the old problems will remain, although in slightly less exacerbated form.

A final prefatory word should be added before the list. The simplest way of solving close-corporation problems is to allocate both profit distribution and power distribution in accordance with share holdings. This is one reason why "stock provisions" are listed first. Also, section 620(a) expressly recognizes the validity of arrangements governing the participants' voting *as shareholders*,¹⁹ and more significantly, such arrangements are not subject to termination, as are director-controlling ones, when shares are transferred to nonparticipants. The desideratum then, is, so far as possible, without becoming "improperly restrictive of the discretion or powers of the directors in their management of corporate affairs,"²⁰ to allocate control over profits and management operation to the shareholders, instead of the board of directors.

III. STOCK PROVISIONS

1. *Restrictions on Transfer of Shares.*—Certain restraints on the transfer of stock are essential to guarantee that whatever corporate arrangement is made for share of profits or control will be maintained. Present law recognizes "reasonable restrictions" on transfer, including a required first offer to the corporation.²¹ The B.C.L. is silent except that section 508(d)²² apparently authorizes such restrictions. The terms

15. Until form bylaws for one-man corporations appear, however, he will at least have to do a penciling job on the outfit ones: "The Corporation shall have one director," "A quorum shall consist of one director," etc.

16. N.Y. Bus. Corp. Law § 702(a) provides: "[T]he number of directors may be less than three but not less than the number of shareholders."

17. N.Y. Bus. Corp. Law § 702(a).

18. Other drafting problems will still remain, e.g., deadlock problems.

19. N.Y. Bus. Corp. Law § 620(a) provides: "An agreement between two or more shareholders, if in writing and signed by the parties thereto, may provide that in exercising any voting rights, the shares held by them shall be voted as therein provided, or as they may agree, or as determined in accordance with a procedure agreed upon by them."

20. N.Y. Bus. Corp. Law § 620(b).

21. *Allen v. Biltmore Tissue Corp.*, 2 N.Y.2d 534, 141 N.E.2d 812, 161 N.Y.S.2d 418 (1957).

22. N.Y. Bus. Corp. Law § 508(d) provides: "Shares shall be transferable in the manner provided by law and in the by-laws."

for share repurchases from retiring estates and estates of deceased participants should also be included.²³

Wherever section 620(b) provisions are used, the shareholder should also be required to give full information on such provisions to any prospective purchaser, and the corporation should be accorded the right to deny transfer of any shares until the transferee executes a statement acknowledging, under oath, that he has full knowledge of such provisions and assents thereto.

2. *Pre-emptive Rights.*—Ordinarily these are essential to prevent a loophole in the close-corporation setup through the issuance of stock to outsiders or participants anxious to secure control. Section 622 of the B.C.L. is basically the same as the old law.²⁴ Hence, it is generally advisable to counteract section 622(e)²⁵ by expressly granting pre-emptive rights in the situations listed.

3. *Limit Authorized Shares.*—Under Section 501(a) of the B.C.L., as under the old law, the certificate must set forth the limit of authorized shares.²⁶ Also, as under the former statute, it is dangerous to authorize the maximum number of shares available at the minimum rate without considering that the issuance of new shares may well upset an otherwise perfect close-corporation setup.²⁷ Directors may issue stock up to the full number of shares authorized.²⁸ Even if pre-emptive rights are available,²⁹ it must be remembered that a shareholder, who does not have enough ready cash to pay the price fixed, may be "frozen out," even

23. It will be recalled that provisions proper for bylaws may properly be placed in the certificate. See note 9 *supra* and accompanying text.

24. N.Y. Stock Corp. Law § 39.

25. N.Y. Bus. Corp. Law § 622(e) provides: "Unless otherwise provided in the certificate of incorporation, shares or other securities offered for sale or subjected to rights or options to purchase shall not be subject to preemptive rights if they: (1) Are to be issued by the board to effect a merger or consolidation or offered or subjected to rights or options for consideration other than cash; (2) Are to be issued or subjected to rights or options under paragraph (d) of Section 505 (Rights and options to purchase shares; issue of rights and options to directors, officers and employees); (3) Are to be issued to satisfy conversion or option rights theretofore granted by the corporation; (4) Are treasury shares; (5) Are part of the shares or other securities of the corporation authorized in its original certificate of incorporation and are issued, sold or optioned within two years from the date of filing such certificate; or (6) Are to be issued under a plan of reorganization approved in a proceeding under any applicable act of congress relating to reorganization of corporations."

26. N.Y. Bus. Corp. Law § 402(a)(4); N.Y. Stock Corp. Law § 5(3).

27. For problems which may otherwise result see *Dunlay v. Avenue M Garage & Repair Co.*, 253 N.Y. 274, 170 N.E. 917 (1930); see also *Ross Transp., Inc. v. Crothers*, 185 Md. 573, 45 A.2d 267 (1946).

28. N.Y. Bus. Corp. Law § 504(c)-(d).

29. See subdivision 2 of text *supra*.

though he is guaranteed a "right" to purchase sufficient shares to maintain his former proportional interest.³⁰

4. *Classes of Shares.*—A way of allocating profit participation through dividends, and of guaranteeing representation on the board to persons with smaller financial participation is provided for in Section 402 of the B.C.L.³¹ Apparently, it is still possible to have shareholder A elect two directors with his one class of stock, while his coshareholder B elects two with his class, equal in dividend rights per share, but smaller in number.

5. *Vote by Classes.*—Under section 617³² class voting is permissible. It may be used in conjunction with classes of shares, examined in subdivision four above. In this connection, section 706(c)(2)³³ should also be considered.

6. *Nonvoting Shares.*—Nonvoting stock, useful for giving profit return proportional to investment while allocating control in a different way so as to accommodate the money versus brains organization, is permissible

30. See *Stokes v. Continental Trust Co.*, 186 N.Y. 285, 78 N.E. 1090 (1906) which held that the shareholder must pay the price (which may be considerably above par) which the board fixes for outsiders. See also *Hyman v. Velsicol Corp.*, 342 Ill. App. 489, 97 N.E.2d 122 (1951).

31. N.Y. Bus. Corp. Law § 402(a) provides: "A certificate . . . shall set forth . . . (4) The aggregate number of shares which the corporation shall have the authority to issue; if such shares are to consist of one class only, the par value of the shares or a statement that the shares are without par value; or, if the shares are to be divided into classes, the number of shares of each class and the par value of the shares having par value and a statement as to which shares, if any, are without par value. (5) If the shares are to be divided into classes, the designation of each class and a statement of the relative rights, preferences and limitations of the shares of each class."

32. N.Y. Bus. Corp. Law § 617 provides: "(a) The certificate of incorporation may contain provisions specifying that any class or classes of shares or of any series thereof shall vote as a class in connection with the transaction of any business or of any specified item of business at a meeting of shareholders, including amendments to the certificate of incorporation. (b) Where voting as a class is provided in the certificate of incorporation, it shall be by the proportionate vote so provided or, if no proportionate vote is provided, in the election of directors, by a plurality of the votes cast at such meeting by the holders of shares of such class entitled to vote in the election, or for any other corporate action, by a majority of the votes cast at such meeting by the holders of shares of such class entitled to vote thereon. (c) Such voting by class shall be in addition to any other vote, including vote by class, required by this chapter and by the certificate of incorporation as permitted by this chapter."

33. N.Y. Bus. Corp. Law § 706(c)(2) provides: "When by the provisions of the certificate of incorporation the holders of the shares of any class or series, or holders of bonds are entitled to elect one or more directors, any director so elected may be removed only by the applicable vote of the holders of the shares of that class or series, or the holders of such bonds, voting as a class." Provision for class voting for directors thus may be a valuable means of guaranteeing the desired control where financial participation is to be unequal.

(as under present law) under section 613.³⁴ Note, however, that shares which are entitled to preference in distribution of dividends or assets must not be labelled "common," while those which have no such preference may not be called "preferred."³⁵

7. *Preferred Stock.*—Another way of providing for disproportionate profit versus control is through preferred stock. Such a provision naturally is permissible,³⁶ if stated in the certificate.³⁷ Cumulative preferred is one way of granting the inactive man a share of the profits which might otherwise all be distributed through salaries to the active participants.

8. *Denial of Right to Board To Fix Preferences.*—The issuance of preferred stock in series is probably unnecessary for a close corporation. It is advisable to deny this right,³⁸ and also to deny the board the right to determine preferences.³⁹

9. *Deny Right to Directors To Fix No-Par Consideration.*—Where no-par stock is used (no very good reason appears for using no-par instead of low-par), and unless additional issuance is prohibited, the shareholders should probably be the ones to control the issuance and consideration. A provision negating power in directors, therefore, should be employed.⁴⁰

34. See also N.Y. Bus. Corp. Law § 501(a).

35. N.Y. Bus. Corp. Law § 501(b). It is probably advisable to entitle preferred and other nonvoting shareholders to vote on merger, consolidation and sale of assets, to avoid a "squeeze-out" by the majority through such devices. See O'Neal & Derwin, *Expulsion or Oppression of Business Associates: "Squeeze-Outs" in Small Enterprises 67-81 (1961)*. Note that not even appraisal rights are available on a cash sale conditioned upon distribution within one year and dissolution. N.Y. Bus. Corp. Law § 910(a)(1)(b). See Hornstein, *McKinney's N.Y. Bus. Corp. Law*, App. 2, pp. 251, 252 (reprinted from 2 Hornstein, *Corporation Law and Practice (Supp. 1962, at 149-50)*). A good "squeeze-out" device is thus provided.

36. N.Y. Bus. Corp. Law § 501(a).

37. N.Y. Bus. Corp. Law § 402(a)(5). See also subdivision 6 of text supra.

38. N.Y. Bus. Corp. Law § 402(a)(6) provides: "A certificate . . . shall set forth . . . If the shares of any preferred class are to be issued in series, the designation of each series and a statement of the variations in the relative rights, preferences and limitations as between series insofar as the same are to be fixed in the certificate of incorporation, and a statement of any authority to be vested in the board to establish and designate series and to fix the variations in the relative rights, preferences and limitations as between series."

39. See N.Y. Bus. Corp. Law § 502(c) which provides: "If any such number of shares or any such designation, relative right, preference or limitation of the shares of any series is not fixed in the certificate of incorporation, it may be fixed by the board, to the extent authorized by the certificate of incorporation."

40. In this connection N.Y. Bus. Corp. Law § 504(d) provides: "Shares without par value may be issued for such consideration as is fixed from time to time by the board unless the certificate of incorporation reserves to the shareholders the right to fix the

10. *Automatic Cancellation of Reacquired Shares.*—The disposition of shares reacquired on the death or retirement of a participant must be considered. If not cancelled, they become treasury shares,⁴¹ and unless the certificate provides otherwise, are not subject to pre-emptive rights.⁴² Even with pre-emptive rights, there are dangers to participants temporarily “strapped for cash.”⁴³ The certificate may, however, provide for automatic cancellation of all reacquired shares.⁴⁴ If this is done, reissuance ought to be forbidden and reduction in the authorized shares should be required.⁴⁵

11. *Deny Right To Issue Rights and Options To Purchase Shares Except by Proper Shareholder Action.*—As indicated previously,⁴⁰ the issuance of new shares can upset the best made close-corporation plans. Unless special additional financing is contemplated, the power to issue such rights or options should probably be denied.⁴⁷

12. *Deny Power To Issue Stock Unless Proper Notice Contained on Certificates.*—Notice of many special close-corporation provisions must be set forth on every certificate of stock⁴⁸ in order to insure the perma-

consideration. If such right is reserved as to any shares, a vote of the shareholders shall either fix the consideration to be received for the shares or authorize the board to fix such consideration.”

41. N.Y. Bus. Corp. Law § 515(b) provides: “Any shares reacquired by the corporation and not required to be cancelled may be either retained as treasury shares or cancelled by the board at the time of reacquisition or at any time thereafter.”

42. N.Y. Bus. Corp. Law § 622(e)(4); see also subdivision 2 of text supra.

43. See subdivision 3 of text supra.

44. N.Y. Bus. Corp. Law § 515(a).

45. N.Y. Bus. Corp. Law § 515(e) provides: “Shares cancelled under this section shall be restored to the status of authorized but unissued shares, except that if the certificate of incorporation prohibits the reissue of any shares required or permitted to be cancelled under this section, the board shall approve and deliver to the department of state a certificate of amendment under section 805 (Certificate of amendment or of change; contents) eliminating such shares from the number of authorized shares.”

46. See subdivisions 2 and 3 of text supra.

47. N.Y. Bus. Corp. Law § 505(a) provides: “Except as otherwise provided in this section or in the certificate of incorporation, a corporation may create and issue, whether or not in connection with the issue and sale of any of its shares or bonds, rights or options entitling the holders thereof to purchase from the corporation shares of any class or series, whether authorized but unissued shares, treasury shares or shares to be purchased or acquired, upon such consideration, terms and conditions as may be fixed by the board.”

48. E.g., N.Y. Bus. Corp. Law § 616(c) (high quorum and vote requirements for shareholder action); N.Y. Bus. Corp. Law § 709(c) (high quorum and vote requirements for director action); N.Y. Bus. Corp. Law § 609(h) (irrevocability of proxies); N.Y. Bus. Corp. Law § 1002 (dissolution provisions); N.Y. Bus. Corp. Law § 508(b) (rights and preferences); N.Y. Bus. Corp. Law § 620(b) (director sterilizing). See also as to restrictions on share transfers N.Y. Pers. Prop. Law § 176; N.Y. Uniform Commercial Code § 8-204 (eff. Sept. 27, 1964).

nence of the close-corporate setup. It would seem to be within the power of the corporation to forbid the issuance of noncomplying certificates,⁴⁹ or at least to prohibit the transfer of them.⁵⁰ In any event, they should be denied voting and dividend rights, if improperly executed or transferred.

If section 620(b) provisions are used, it is best to require that these be set out in full on the stock certificates, and that no shares will be validly transferred without execution by the transferee of a sworn statement acknowledging his knowledge of and assent to all of said provisions.

13. *Notice on Certificates of Close-Corporate Provisions.*—As noted above, all certificates for shares should bear proper “notice”—at least a reference to the applicable charter and bylaw provisions—of all special close-corporation provisions. Where section 620(b) provisions are used, they should probably be set forth in full. The certificate of incorporation ought to prescribe the form of notice.⁵¹

14. *Deny Right To Issue Any Stock (Even Though Part of Authorized) Without Shareholder Approval.*—A prohibition against the issuance of stock without shareholder approval is especially desirable where authorized shares exceed issued shares. Such a limitation, however, might be considered as improperly restrictive of the discretion of the directors, *i.e.*, constitute a section 620(b) provision. Granting pre-emptive rights in all unissued stock after a certain date would not seem subject to this objection.⁵²

15. *Cumulative Voting.*—Where financial participation is to be unequal, but assurance of some control to the minority is desired without use of classes of shares, cumulative voting may be used to secure board representation to the financial minority. As under present law, provisions for cumulative voting must be in the certificate of incorporation.⁵³ Obviously, the number of shares must also be sufficient under the formula,⁵⁴ and classification of the terms of directors⁵⁵ (ordinarily not

49. N.Y. Bus. Corp. Law § 402(b).

50. N.Y. Bus. Corp. Law § 503(d).

51. Such a provision would seem to be permissible in the certificate under N.Y. Bus. Corp. Law § 402(b).

52. In this regard N.Y. Bus. Corp. Law § 622(e) states: “Unless otherwise provided in the certificate of incorporation, shares or other securities offered for sale or subjected to rights or options to purchase shall not be subject to preemptive rights if they . . . (5) Are part of the shares or other securities of the corporation authorized in its original certificate of incorporation and are issued, sold or optioned within two years from the date of filing such certificate. . . .”

53. N.Y. Bus. Corp. Law § 618.

54. Williams, *Cumulative Voting for Directors* 40-42 (1951).

55. N.Y. Bus. Corp. Law § 704.

advisable for close corporations) should not be used unless the number of directors at each election is sufficient under the formula.⁵⁶

IV. MANAGEMENT STRUCTURE

A. *Shareholders vs. Directors*

16. *High Vote and Quorum Requirements for Shareholder and Director Action.*—A veto over corporate action may still be given to a minority financial interest through the use of high quorum and high vote requirements. The provisions of Section 9 of the Stock Corporation Law are carried over in B.C.L. Section 616, as to shareholders, and B.C.L. Section 709, as to directors. Where, however, unanimity is required for all actions, probabilities of deadlock are multiplied. In some instances, selective use, *e.g.*, for amendment of the bylaws and certificate, election of directors,⁵⁷ and so forth, may be advisable. As under the present law, these provisions must be in the certificate to be valid. It should be *specifically* stated in the certificate that the deletion of section 616 and section 709 provisions is only permitted when approved by a specified percentage of shareholders. Otherwise, two-thirds of the voting shareholders will be able to excise a unanimity requirement.⁵⁸ Of course, if unanimous quorum requirements necessitate that notice of adjourned shareholder and director meetings be given to absent persons,⁵⁹ such explicit charter provisions may not be necessary.

17. *Limit Number of Directors.*—The number of directors (not even the minimum-maximum) need not be fixed in the certificate.⁶⁰ "Packing the board" is a good way of shifting the original corporate control setup. Obviously, if the number is set forth in the certificate and high voting requirements are present, this cannot be done. Changes in the number should also be subject to "high-vote" shareholder approval.⁶¹

56. For these reasons subdivision 4 of text *supra* seems to be preferable.

57. This is especially important because under N.Y. Bus. Corp. Law § 706(d) an action to remove a director "for cause" may be brought by 10% of the shareholders even though they are nonvoting. See *Campbell v. Loew's, Inc.*, 134 A.2d 852 (Del. Ch. 1957) where the court held that "a planned scheme of harassment" constituted legal basis for removing a director. A requirement for unanimity to elect a new director should help to frustrate this statute, since if the removed director is a shareholder, he can prevent the election of any successor not satisfactory to him. Perhaps also high director vote should be required to prevent petition for dissolution under N.Y. Bus. Corp. Law § 1102.

58. See Hoffman, *New Horizons for the Close Corporation in New York Under Its New Business Corporation Law*, 28 Brooklyn L. Rev. 1, 5 (1961). See also subdivision 17 of text *infra*.

59. See N.Y. Bus. Corp. Law §§ 605(b), 711(d).

60. N.Y. Bus. Corp. Law § 702(a).

61. N.Y. Bus. Corp. Law § 702(b) provides that the number of directors may be changed

18. *Directors Must Be Shareholders.*—Under section 701 the only requirement for directors is that they be twenty-one years of age. Thus, they need not be shareholders unless the certificate or bylaws so require. Not only this qualification, however (which will guarantee against outsiders), but presumably others, e.g., as to quantity of share ownership, would seem permissible.⁶²

19. *Vacancies on Board To Be Filled by Shareholders.*—Section 705 of the B.C.L. provides that newly created directorships and vacancies may be filled by the directors, unless the certificate or bylaws provide otherwise. Note, this is a loophole which should be plugged. If it is not, a situation as in *Gearing v. Kelly*⁶³ could recur.

20. *Removal of Directors Without Cause.*—This is not advisable unless dummies are used.⁶⁴ Where they are, the certificate or bylaws may provide for removal by shareholders.⁶⁵ Obviously, it is never advisable where the board reflects real corporate participation, unless a high shareholder vote requirement prevents removal of a minority representative.

21. *Deny Directors Power To Remove Other Directors.*—This prohibition is not really necessary, but it does prevent later adoption of a bylaw allowing such a removal.⁶⁶

22. *Deny Directors Power To Fix Their Own Compensation.*—Representation on the board may not be proportional to share interest. Salaries are a way of allocating distribution of corporate profits in lieu of dividends. The matter should, therefore, ordinarily be left to the shareholders, where financial interest may be reflected in voting rights. Unless the right is denied them, however, directors have the power to fix their own compensation.⁶⁷

23. *Deny Directors the Power To Mortgage or Pledge Assets.*—This is another loophole which should be plugged in order to prevent the

by amendment of the bylaws, or by action of the board or shareholders if the bylaws allow. It would seem desirable to forbid bylaw change in this regard (this would seem legal under N.Y. Bus. Corp. Law § 402(b)), or to impose high vote and quorum requirements to amend the bylaws or at least this provision.

62. N.Y. Bus. Corp. Law § 701 provides: "The certificate of incorporation or the bylaws may prescribe other qualifications for directors."

63. 15 App. Div. 2d 219, 222 N.Y.S.2d 474 (1st Dep't 1961), aff'd, 11 N.Y.2d 201, 182 N.E.2d 391, 227 N.Y.S.2d 897 (1962).

64. Compare Stevens, *Close Corporations and the New York Business Corporation Law of 1961*, 11 Buffalo L. Rev. 481, 489 (1962). Stevens seems to regard the statutory authorization (N.Y. Bus. Corp. Law § 706(b)) for such a provision as important to close corporations. It may, however, be double-edged.

65. N.Y. Bus. Corp. Law § 706(b).

66. N.Y. Bus. Corp. Law § 706(a).

67. N.Y. Bus. Corp. Law § 713(c).

sabotaging of the entire corporation. If the certificate does not provide otherwise, shareholder consent is not necessary.⁶⁸

24. *Limit the Permissible Contents of the Bylaws.*—It is safer to have basic control matters dealt with in the certificate rather than the bylaws, simply because it may be more difficult to alter.⁶⁹ Important provisions thus should be withdrawn from bylaw change.⁷⁰

25. *Expressly Deny Directors the Right To Amend Bylaws.*—Directors have the power to amend, repeal or adopt bylaws "under authority granted by the certificate. . . ."⁷¹ While this probably means that they do not have the right unless the certificate grants it, it is safer to deny the right expressly.

26. *"Sterilizing" the Board.*—This apparently may be done, but only under authority of section 620(b), and subject to its limitations. Presumably, all powers can be taken from the board, but a corporation must still have to have one.⁷² As indicated above, provisions which remove powers which the board ordinarily would possess should be separately stated at the end of provisions justified by other sections of the law. A prefatory statement, such as, "so long as the following are permitted under Section 620(b) of the Business Corporation Law . . ." might be advisable, after a statement that "none of the foregoing are to be terminated as a result of the termination of the effectiveness of the following."

B. Officers

27. *Officers To Be Elected by Shareholders.*—The new law⁷³ allows election of officers by shareholders. This validates shareholder (and certificate) provisions guaranteeing continuation of office and set salaries.⁷⁴

28. *Prescribe Powers of Officers.*—Although attempts at denying the ordinary powers of officers may fail as to outsiders, duties may be prescribed vis-à-vis the corporation.⁷⁵ Consider dividing duties, *e.g.*, the

68. N.Y. Bus. Corp. Law § 911.

69. N.Y. Bus. Corp. Law § 601(b) provides: "The by-laws may contain any provision relating to the business of the corporation, the conduct of its affairs, its rights or powers or the rights or powers of its shareholders, directors or officers, not inconsistent with this chapter or any other statute of this state or the certificate of incorporation."

70. Consider forbidding bylaws to allow removal of director by shareholders. See note 64 *supra*.

71. N.Y. Bus. Corp. Law § 601(a).

72. See note 8 *supra*.

73. N.Y. Bus. Corp. Law § 715(b).

74. See Kessler, *The New York Business Corporation Law*, 36 *St. John's L. Rev.* 1, 54-55 (1961). But see subdivision 29 of text *infra*.

75. N.Y. Bus. Corp. Law § 715(g).

signing of checks, among officers from different factions and denying powers to dummy officers appointed. *Quaere*: Must a corporation have the ordinary complement of officers?⁷⁰

29. *Officers' Terms.*—Provisions should be made to avoid the termination of office at the next annual meeting.⁷⁷

30. *Removal of Officers Without Cause.*—Officers elected by the shareholders may be removed only by them.⁷⁸ This may be without cause, and, hence, is dangerous to the minority unless a high shareholder vote is required. Note that director-appointed officers are removable by directors, even without cause.⁷⁹

31. *Deny Loss of Salary to Officers on Suspension.*—Even officers appointed by the shareholders may be suspended by the board.⁸⁰ It is advisable to provide that such suspension will not mean suspension of salary for participant officers.⁸¹ Also, perhaps a pension for removed or suspended officers might be wise.⁸²

32. *Designate Important Persons by Special (Nonofficer) Titles.*—Because of the board's power of suspension of officers under section 716(a), and since an action to remove officers "for cause" may be brought by ten per cent of the shareholders, even though nonvoting,⁸³

76. N.Y. Bus. Corp. Law § 715(a) provides: "The board may elect or appoint a president, one or more vice-presidents, a secretary and a treasurer, and such other officers as it may determine, or as may be provided in the by-laws." Consider also, e.g., such provisions as those involved in *In the Matter of Venice Amusement Corp.*, 32 Misc. 2d 122, 222 N.Y.S.2d 889 (Sup. Ct. 1961), rev'd on other grounds, 14 App. Div. 2d 742, 220 N.Y.S.2d 47 (1st Dep't 1961) (memorandum decision). The lower court summarized them as follows: "[T]he corporate by-laws prohibit the president from appointing, employing or removing any agent or employee without the concurrence of the vice-president and secretary and without the prior approval of the board of directors . . . and from taking any corporate action or transacting any corporate business without the prior consent of the vice-president and the secretary. All notes and bills payable, checks, drafts, warrants and other negotiable instruments and contracts require the signature of the secretary or treasurer and the counter-signature of the president or vice-president. All other corporate documents require the signatures of three officers." *Id.* at 123-24, 222 N.Y.S.2d at 890. Upon the death of one of the participants the court held that dissolution was "justified, if not required," since "further transaction of business by the officers and directors was illegal under the charter and by-laws of the corporation." *Id.* at 124, 222 N.Y.S.2d at 890.

77. N.Y. Bus. Corp. Law § 715(c).

78. N.Y. Bus. Corp. Law § 716(a).

79. *Ibid.*

80. *Ibid.*

81. N.Y. Bus. Corp. Law § 716(b) provides: "The removal of an officer without cause shall be without prejudice to his contract rights, if any. The election or appointment of an officer shall not of itself create contract rights."

82. See N.Y. Bus. Corp. Law § 202(13).

83. N.Y. Bus. Corp. Law § 716(c).

it is advisable to have important high-salaried jobs given to "general managers," "plant managers," "store managers," "general superintendents," and so forth, instead of "officers." *Quaere*: Is denying directors the power to suspend these nonofficers a section 620(b) provision? Perhaps it would be advisable to give key brain participants long-term contracts with appropriate damage clauses, without mention of the job in the certificate, but with a general provision authorizing such positions.

33. *Long-Term Employment Contracts*.—Any close corporation should be expressly empowered to enter into long-term employment contracts, although even if not expressly authorized, such contracts are probably valid, if made for a reasonable time.⁸⁴

V. DEADLOCK PROVISIONS

34. *Dissolution*.—Section 1002 of the B.C.L. allows a certificate of incorporation to provide that any shareholder, or the holders of any specified number or proportion of the total outstanding shares may enforce dissolution of the corporation at will or upon the occurrence of any specified event.⁸⁵ A draftsman should provide conditions of dissolution as far as possible.⁸⁶ Section 1104(b) or (c) provisions⁸⁷ cannot be avoided, but a draftsman may deny the right under section 1104(a).⁸⁸

84. See N.Y. Bus. Corp. Law §§ 202(a)(7), 202(a)(10), 715(c), 716(b). See also Henn, *Corporations and Other Business Enterprises* 351 (1961). The contract should perhaps give the employee the option to renew. In this way the term of the contract can be limited to a shorter period, i.e., be "reasonable," and still give the employee adequate protection.

85. E.g., consideration should be given providing for automatic dissolution upon removal of any director. See note 86 *infra*.

86. See, e.g., 2 O'Neal, *Close Corporations* § 10.28 (1958) giving a shareholder the right to dissolve unless other shareholders buy him out.

87. N.Y. Bus. Corp. Law § 1104 provides: "(b) If the certificate of incorporation provides that the proportion of votes required for action by the board, or the proportion of votes of shareholders required for election of directors, shall be greater than that otherwise required by this chapter, such a petition may be presented by the holders of more than one-third of all outstanding shares entitled to vote on dissolution under article 10 (Non-judicial dissolution). (c) Notwithstanding any provision in the certificate of incorporation, any holder of shares entitled to vote at an election of directors of a corporation, may present a petition for its dissolution on the ground that the shareholders are so divided that they have failed, for a period which includes at least two consecutive annual meeting dates, to elect successors to directors whose terms have expired or would have expired upon the election and qualification of their successors."

88. N.Y. Bus. Corp. Law § 1104(a) provides: "Unless otherwise provided in the certificate of incorporation, the holders of one-half of all outstanding shares of a corporation entitled to vote in an election of directors may present a petition for dissolution on one or more of the following grounds: (1) That the directors are so divided respecting the management of the corporation's affairs that the votes required for action by the board cannot be obtained.

35. *Arbitration.*—Under the B.C.L. there is no specific authorization for arbitration. Parties may agree to arbitrate even nonjusticiable questions under the new New York Civil Practice Law and Rules which will replace the Civil Practice Act.⁸⁹ Whether or not a director should be removed is apparently also arbitrable now.⁹⁰

VI. ADDITIONAL PROVISIONS

36. *Inspection Rights.*—B.C.L. Section 624 is probably not intended to change the common-law right of inspection of corporate books. Apparently, it is possible to extend inspection rights if desired.

37. *Director Sterilizing Provisions.*—Director "sterilization" may be accomplished in many ways, e.g., stripping the board of all power; transfer of all management to an officer or outsider; provisions requiring shareholder approval of all director action; limiting the power of the directors to fire officers or change their salaries (unless subdivision 27 supra is used); perhaps even the financial arrangement provisions of a *Clark v. Dodge*⁹¹ agreement may be construed to be "director sterilizing" provisions. Director sterilizing provisions must be in the certificate of incorporation (if inserted by amendment, unanimous shareholder approval by voting and nonvoting shareholders is required),⁹² and are subject to automatic termination as discussed above.

38. *Irrevocable Proxies.*—Irrevocable proxies may now be given in connection with a shareholders' voting agreement.⁹³ This is useful to insure that an agreed upon voting plan will be carried out. It is probably best to mention the authority for this provision in the certificate.

39. *Others.*—B.C.L. Section 402(b) provides:

The certificate of incorporation may set forth any provision, not inconsistent with this chapter or any other statute of this state, relating to the business of the corporation, its affairs, its rights or powers, or the rights or powers of its shareholders, directors or officers including any provision relating to matters which under this chapter are required or permitted to be set forth in the by-laws. It is not necessary

(2) That the shareholders are so divided that the votes required for the election of directors cannot be obtained. (3) That there is internal dissension and two or more factions of shareholders are so divided that dissolution would be beneficial to the shareholders."

89. N.Y. Civ. Prac. Law & R. § 7501, effective Sept. 1, 1963, provides: "A written agreement to submit any controversy thereafter arising or any existing controversy to arbitration is enforceable without regard to the justiciable character of the controversy and confers jurisdiction on the courts of the state to enforce it and to enter judgment on an award."

90. See comment to N.Y. Bus. Corp. Law § 706(d); see also Kessler, supra note 74, at 59-60.

91. 269 N.Y. 410, 199 N.E. 641 (1936).

92. N.Y. Bus. Corp. Law § 620(b).

93. N.Y. Bus. Corp. Law § 609(f)(5). Compare *Ringling Bros.-Barnum & Bailey Combined Shows, Inc. v. Ringling*, 29 Del. Ch. 610, 53 A.2d 441 (Sup. Ct. 1947).

to set forth in the certificate of incorporation any of the powers enumerated in this chapter.

Quaere: Whether these provisions can go further than was allowed under the old law⁹⁴ without being considered section 620(b) provisions?

VII. SUMMARY

It has been previously stated, but bears reiteration, that this has been a mere *checklist* of provisions which a lawyer *might* consider inserting in the certificate of incorporation of his closely held corporations when the new New York B.C.L. goes into effect.⁹⁵ Some of the provisions are inconsistent with one another. Many will be unnecessary if others are used. Most may be omitted if the lawyer is willing to place his confidence in the proper interpretation of Section 620(b) of the B.C.L. Other provisions may seem essential which have not even been mentioned. At least, however, this list should point up areas of draftsmanship from which the close-corporation lawyer may draw a few aids in the difficult task of properly launching his close-corporation clients on the road to successful operation.

94. See Stevens, *supra* note 64, at 487.

95. It goes without saying, of course, that all of the provisions required by N.Y. Bus. Corp. Law § 402 (certificate of incorporation; contents) must also be inserted. Undoubtedly, a printed Blumberg form will be available when the law goes into effect, and will prevent omission of such required statements as the name of the corporation, its purpose, the location of its office, designation of the secretary of state as process agent, etc.