The Shareholder-Managed Close Corporation Under the New York Business Corporation Law

Robert A. Kessler
The Shareholder-Managed Close Corporation Under the New York Business Corporation Law

Cover Page Footnote
Professor of Law, Fordham University School of Law. Professor Kessler received his B.A. from Yale University, his J.D. from Columbia University and his L.L.M. from New York University. He has authored two books and numerous articles on close corporations.

This article is available in Fordham Law Review: https://ir.lawnet.fordham.edu/flr/vol43/iss2/2
THE SHAREHOLDER-MANAGED CLOSE CORPORATION UNDER THE NEW YORK BUSINESS CORPORATION LAW

ROBERT A. KESSLER*

I. INTRODUCTION

O one needs to be reminded of the rapidity with which changes have taken place in the past few years in every aspect of human affairs. It is no wonder, then, that the New York Business Corporation Law's close corporation provisions, hailed on their adoption as pioneering a new era for the small corporation have, in the decade since their effective date, been outstripped in modernity by the enactments of many other states. New York was the first state expressly to authorize high vote and quorum requirements for director and shareholder action. This well-known "veto power," so popular in close corporations, was an innovation which long antedated the Business Corporation Law, and was subsequently incorporated into it. The Business Corporation Law also added such now familiar aids to the close corporation as mini-boards, multiple office-holdings and special dissolution provisions.

The most important accommodation to the close corporation's peculiar needs was, however, found in section 620:

(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

* Professor of Law, Fordham University School of Law. Professor Kessler received his B.A. from Yale University, his J.D. from Columbia University and his LL.M. from New York University. He has authored two books and numerous articles on close corporations.


6. Id. § 1002 (McKinney 1963).
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 because it improperly restricts the board in its management of the business of the corporation, or improperly transfers to one or more shareholders or to one or more persons or corporations to be selected by him or them, all or any part of such management otherwise within the authority of the board under 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, 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 no shares of the corporation are listed on a national securities exchange or regularly quoted in an over-the-counter market by one or more members of a national or affiliated securities association.7

Subsection (a) merely gave the legislative imprimatur to the almost universally recognized shareholder pooling agreement.8 Subsection (b) was designed to solve the more difficult problem of shareholder agreements which impinge on the ordinary powers of directors to manage the corporation. The history of judicial repression of such agreements prior to the enactment of section 620(b) is well known to students of the subject. Manson v. Curtis9 invalidated an agreement which called for a passive board. McQuade v. Stoneham10 invalidated a non-unanimous shareholder agreement to retain an officer at a specified salary because, at the time, the selection of officers and their compensation was an exclusively directorial function.11 When, however, the subsequent Clark v. Dodge12 decision upheld an agreement which interfered even more seriously with powers of the board of directors, but had been approved by the two shareholders who owned all of the corporation's stock, close corporation lawyers took

7. Id. §§ 620(a), (b), (c), as amended, N.Y. Bus. Corp. Law §§ 620(a), (b), (c) (McKinney Supp. 1973). The amendments only made slight clarificatory changes in the original version. Subsections (d) through (g), not quoted in the text, deal with certificate amendments to strike a § 620(b) provision, the effect of a § 620(b) provision in imposing managerial responsibility on the shareholders, and the requirement that the existence of such a provision be noted on the corporation's share certificates.
11. N.Y. Bus. Corp. Law § 715(b) (McKinney 1963) now allows the certificate of incorporation to contain a provision for shareholder election of officers, thereby removing (for corporations which elect to place the required language in the certificate) the objection that such an agreement interferes with board powers.
12. 269 N.Y. 410, 199 N.E. 641 (1936) (the contract upheld by the court provided that Clark was to be retained as general manager and was to be paid one quarter of the corporation's net income; it also provided that the defendant would vote for the plaintiff as a director).
comfort in the confidence that director-impinging shareholder agreements would be valid as long as they were unanimous.

These hopes were soon dashed by the decision in *Long Park, Inc. v. Trenton-New Brunswick Theatres Co.* 13 There, the New York Court of Appeals distinguished *Clark v. Dodge* and invalidated a contract, unanimously approved by the shareholders, which transferred management for nineteen years to an outside corporation. The interference with board management powers in *Long Park* was found to be more than the "slight impingement or innocuous variance from the statutory norm" which was the case in *Clark v. Dodge*. 14 This was where matters stood when section 620(b) was enacted.

After some waiving, 15 the legislative committee decided that the purpose of the section was to "expand the ruling in Clark v. Dodge" and, "to the extent therein provided," to overrule *Manson, McQuade* and *Long Park*. 16 Presumably, the qualification to the overruling refers merely to the necessity for compliance with the provisions of the statute in order to obtain its benefits. 17

Unfortunately, despite the length of time which has elapsed since its enactment, neither the court of appeals nor any other court has given a definitive exposition of the scope of the section. It is clear from the language of section 620(b) itself, however, that the required certificate of incorporation provision can transfer "to one or more shareholders or to one or more persons or corporations to be selected by him or them, all or any part of such management otherwise within the authority of the board . . . ." 18 It seems equally clear that such a provision can be individualized to the extent of naming a particular person or corporation which is to perform the management function as in *Long Park*.

15. See N.Y. Joint Legislative Comm. to Study Revision of Corporation Laws—Supplement to Fourth Interim Report to 1960 Sess. of New York State Legislature, Legislative Doc. (1960) No. 15 § 6.13, reprinted in [1960] N.Y. Leg. Doc., No. 15 at 36. The original Comment intimated that even a *Clark v. Dodge* restriction on the board would have to be inserted in the certificate, and left some uncertainty as to whether arrangements which completely deprived the board of power would be valid.
16. N.Y. Bus. Corp. Law § 620(b), Comment at 418 (McKinney 1963). Other portions of the final Comment to § 620 read in pertinent part: "The provision authorized by paragraph (b) can be contained only in the certificate of incorporation. Because of the limitations that it must have unanimous consent of all shareholders, whether or not entitled to vote, and that the shares of the corporation must not be publicly listed or quoted either at the time of the agreement or thereafter, this provision can be practically used only in close corporations. . . . Notice of the existence of a provision authorized by this section must be stated on the certificates for shares." Id.
17. The later amendments to the section would not seem to affect the validity of this statement of legislative purpose. See note 7 supra.
Most close corporation participants who are dissatisfied with the ordinary management paradigm, however, probably desire instead to retain power for themselves as a group and to operate pursuant to a partnership-type agreement which completely details their power-financial relationship and the entire mode of operation and termination of the enterprise. The statutes of a number of states today expressly empower them to do just that. Thus, what is probably the best drafted\(^{19}\) of the new close corporation statutes, that of Maryland, expressly authorizes abolition of the board of directors\(^{20}\) and contains the following section on stockholders' agreements:

(a) The stockholders of a close corporation may, by an agreement to which all of the stockholders of the corporation have actually assented, regulate any aspect of the affairs of the corporation or the relations of the stockholders, including, but not limited to:

1. The management of the business and affairs of the corporation;
2. Restrictions on the transfer of stock;
3. The right of one or more stockholders to dissolution of the corporation at will or upon the occurrence of a specified event or contingency;
4. The exercise or division of voting power;
5. The terms and conditions of the employment of any officer or employee regardless of the length of the period of such employment;
6. The persons who shall be directors and officers of the corporation; and
7. The payment of dividends or division of profits.

Such stockholders' agreement shall be embodied in the charter, the bylaws or a written instrument signed by all of the stockholders of the corporation.

(b) A stockholders' agreement authorized by this section shall not be amended except by the unanimous written consent of all stockholders then parties to the agreement.

(c) A stockholder who acquires his stock after a stockholders' agreement authorized by this section has become effective, shall be deemed to have actually assented to, and shall be a party to, such agreement if at the time of acquiring his stock the stockholder has actual knowledge of the existence of the agreement; provided, however, that any stockholder whose stock was acquired by gift or bequest from a person who was a party to a stockholders' agreement authorized by this section, shall be deemed to have actually assented to, and shall be a party to, such stockholders' agreement whether or not he had knowledge of such agreement at the time of acquiring his stock.

(d) A stockholders' agreement authorized by this section may, in the discretion of a court of equity, be enforced by injunction or by such other relief as the court may determine to be fair and appropriate in the circumstances. As an alternative to the granting of an injunction or other equitable relief, the court may, upon the motion of a party to the proceeding, order dissolution of the corporation under the provisions of § 109 (b) and (c) of this article.

(e) Nothing in this section shall otherwise affect otherwise valid agreements among stockholders of a close or other corporation. (1967, ch. 649, § 14.)\(^{21}\)

---


21. Id. § 104. In order to be a "close corporation" entitled to utilize § 104, all that is required is a statement to that effect in its charter documents. Id. § 100(a).
Almost identical provisions for omnibus shareholder management agreements are found in the earlier Florida statute. Manifestly, such statutes allow close corporations virtually the same flexibility as is given to a partnership. A number of other recent corporation statutes also recognize the independent validity of shareholder agreements even though they deal with the management of the corporation and thereby impinge on the powers of the directors.

By contrast, section 620(b) does not validate even a unanimous director-impinging agreement which goes beyond Clark v. Dodge, but only a certificate “provision.” There is no express authorization in the New York section for validation of such an agreement through reference to it in the certificate of incorporation, as may be found, for example, in the South Carolina statute. Nor does the New York statute authorize setting forth the agreement in full in the certificate, as is allowed by the Florida statute. Furthermore, the New York Department of State would undoubtedly reject a certificate which did the latter; and the former, even if accepted, would probably be insufficient compliance with the statute to insure judicial enforceability.

The problem, then, for New York attorneys whose close corporation clients want to secure the benefits of operating in partnership style, is somehow to secure the benefits of the Maryland and Florida statutes, while complying with the strictures of the less liberal New York Business Corporation Law.

II. How Far Can One Go Under Section 620(b)?

Statutes like that of Maryland allow a very good approximation of partnership operation for the close corporation—exactly what most participants in such corporations want. Professor O'Neal, commenting on a 1971 New York Court of Appeals decision, has suggested that

27. Compare the Maryland statute set forth in text accompanying note 21 supra with the partnership agreement (with optional provisions) in J. Crane & A. Bromberg, Partnership 597-613 (1968).
the New York legislature should amend the statute to validate shareholder agreements and by-law provisions for high vote requirements. It would be better still if the legislature adopted a provision like that in the Maryland statute which goes much further by validating any unanimous shareholder agreement even though it effectively makes the corporation a partnership, while retaining the added corporate advantage of limited liability. Until the legislature does so, it is advisable for New York close corporations to attempt to get as many of the advantages of the Maryland statute as they can under the present law. The simplest way of doing this is to consider the various sections of the Maryland statute and explore their potential availability through manipulation of section 620(b), and other related sections of the New York statute.

A. Management

The Maryland statute allows a shareholder agreement to regulate "[t]he management of the business and affairs of the corporation." As the "Beresovski" clause was part of a shareholder agreement. It provided: "[I]f any illegal provision [of the shareholder agreement] can be cured by amending the certificate of incorporation, the parties agree to take such action immediately." Id. at 423, 271 N.E.2d at 522, 322 N.Y.S.2d at 675.

29. With his customary accuracy and perception Professor O'Neal discusses the case as follows: "The apparent willingness of the Court of Appeals in the Beresovski case to specifically enforce an express undertaking in a shareholders' agreement to amend a corporation's charter to insert high vote requirements for shareholder and director action opens up the possibility that by a two-step process a shareholder can enforce in New York a shareholders' agreement or a bylaw fixing high vote requirements but making no express mention of amendment of the charter. If shareholders enter into an agreement fixing high vote requirements do they not implicitly undertake to do what should be done to make their agreement effective or at least to take reasonable action to implement it? And in this setting should not bylaws be treated as a contract among those shareholders who approve the bylaws? If the answers to these questions are in the affirmative, a shareholder could bring an action first to enforce specifically the implied contractual undertaking to amend the charter to insert high vote requirements and then to enforce the high vote requirements after they had been inserted in the charter.

"If the courts would recognize in shareholders' agreements and bylaws fixing high vote requirements an implied undertaking by parties to an agreement and shareholders who have approved bylaws to take the kind of action that was expressly promised by the parties to the agreement in the Beresovski case, namely, to amend the charter to implement the agreement, they could reach a just and wise result in that they would gratify the reasonable expectations of businessmen, often unsophisticated in legal matters, and protect them against the mistakes of careless, inept, or uninformed lawyers and perhaps on occasion even the misconduct of an unethical lawyer who (purporting to represent all the shareholders in a corporation) might let some of them rely on a shareholders' agreement or a bylaw he knows is unenforceable unless implemented by appropriate charter provisions.

"An even better solution of course would be for the New York legislature to amend the statute to make shareholders' agreements and bylaws fixing high vote requirements valid and enforceable." 1 F. O'Neal, Close Corporations § 4.14 n.7 (Cum. Supp. 1974).

30. See note 21 supra and accompanying text.
indicated above, there is no controlling New York case law. However, one of the principal draftsmen of the New York statute, Samuel Hoffman, has written the following about section 620(b):

The clear import of paragraph (b) of section 620 is to authorize the owners of the close corporate enterprise to manage its affairs directly, as in the case of the partnership, without the impediments inherent in formal board operation. It is abundantly clear that Clark v. Dodge has been codified and extended, and that Long Park, Inc. v. Trenton-New Brunswick Theatres Co. has been legislatively overruled. It is clear, likewise, that there are no limitations, if section 620 is satisfied, on the extent to which the authority of the board can be invaded. Presumably, the board can be deposed of authority and entirely "put to bed."  

The New York Department of State has indicated its agreement with this interpretation and permits the filing of a certificate of incorporation that contains a provision transferring corporate management from the directors to the shareholders. It would seem, therefore, reasonably safe to rely on the validity of such a delegation. In the absence of certificate delegation of management to the shareholders, the extent of shareholder intrusion on management by virtue of even unanimous agreement is uncertain, and complete delegation of director power seems clearly proscribed.

Accordingly, a section 620(b) certificate provision delegating all power to the shareholders may be the only way of securing the complete benefits of the Maryland statutory provision, since such a delegation would then validate a shareholder management agreement under section 620(a).


32. Professor Fogelman, accordingly, suggests the following provision: "All managerial acts in the conduct of the corporate affairs shall be authorized or consented to by the shareholders and the board shall have no discretion or power in connection therewith." McKinney's Forms, Bus. Corp. Law § 7:20 (1965).

Another leading text, 3 White Form No. 620:1, proposes the following language: "All of the powers of the Board of Directors in the conduct and management of corporate affairs are assumed by the shareholders." See also id. Form No. 620:3 which commences: "The business of the corporation and the conduct of its affairs shall be managed by its common shareholders . . . ."


B. Transfer of Stock

The Maryland statute allows a shareholder agreement to impose restrictions on the transfer of stock.35 The only general statutory provision on the subject in New York, except for Article 8 of the Uniform Commercial Code with its implied recognition of such restrictions,36 is section 508(d) of the Business Corporation Law which merely provides that "[s]hares shall be transferable in the manner provided by law and in the by-laws."37 However, "reasonable" share transfer restrictions imposed by shareholder agreement were recognized as valid even before enactment of the Business Corporation Law,38 and, undoubtedly, continue to be permissible. Furthermore, the Business Corporation Law expressly recognizes the validity of one form of such "restriction"—a corporate contract to repurchase a holder's shares.39

Thus, while the full range of share transfer restrictions possible under more modern statutes40 may not be available to New York close corporations, the common first option and repurchase-on-death plans can be incorporated into shareholder agreements even without reliance on the close corporation provision of the statute.

C. Dissolution

The Maryland statute allows a shareholder agreement to set forth "[t]he right of one or more stockholders to dissolution of the corporation at will or upon the occurrence of a specified event or contingency."41 Section 1002 of the New York Business Corporation Law is practically identical in language, except that, like section 620(b), it requires a certificate of incorporation provision.42 There is, therefore, a question as to whether a mere agreement providing for dissolution under specified circumstances will be valid unless accompanied by a sufficient certificate provision. Unfortunately, no re-
Section 1001 allows the holders of two-thirds of the outstanding shares to dissolve the corporation. No director action is required. Accordingly, a dissolution agreement does not constitute an intrusion on board powers, and section 620(b) is not brought into play. Since the matter is on the shareholder level, an agreement which provides that the shareholders will vote for dissolution under conditions set forth in their agreement should be as valid as any other agreement as to how they will vote their shares as shareholders.

The late Carlos Israels, an acknowledged expert on corporate law, believed that such an agreement would have been upheld under the old law, and he saw no reason to change that opinion, despite the enactment of section 1002. In his last book, discussing the problem of deadlock, he stated:

Absence a provision of the certificate of incorporation permitting dissolution at the instance of a minority . . . , dissolution can be brought about only by the vote of the statutory two-thirds majority . . . . However, such a vote may be obtainable by means of a provision of a shareholders' agreement, valid under N.Y. BCL § 620(a) and Del. GCL § 218(c) as an agreement to vote shares as therein provided, which in the event of one or more specified events or contingencies would require that the shareholders cast their votes for dissolution.

Unfortunately, however, Professor Israels' interpretation is not shared by Professor Hoffman. Referring to the Business Corporation Law section which became the present certificate-dissolution provision (section 1002), he has stated:

43. Manis v. Miller, 24 App. Div. 2d 741, 263 N.Y.S.2d 503 (1st Dep't 1965) (mem.), aff'd mem., 19 N.Y.2d 875, 227 N.E.2d 596, 280 N.Y.S.2d 675 (1967), dealt with an agreement allowing a shareholder to dissolve a corporation if his shares were not repurchased. Although the court referred to a "de facto dissolution" resulting from the failure of the other shareholders to carry out the agreement, it held that, in the absence of a legal dissolution, the defendant shareholder whose shares were not repurchased was not freed from his fiduciary obligation not to take over the corporate business for himself. The case is, therefore, hardly authority one way or the other as to the validity of a dissolution agreement.

44. N.Y. Bus. Corp. Law § 1001 (McKinney 1963) provides: "A corporation may be dissolved under this article. Such dissolution shall be authorized at a meeting of shareholders by the vote of the holders of two-thirds of all outstanding shares entitled to vote thereon, except as otherwise provided under section 1002 . . . ."

45. See id. § 620(a), as amended, N.Y. Bus. Corp. Law § 620(a) (McKinney Supp. 1973), set out at text accompanying note 7 supra.

46. C. Israels, Corporate Practice § 4.30 (2d ed. 1969); see In re Hega Knitting Mills, Inc., 124 N.Y.S.2d 115 (Sup. Ct. 1953) (upholding, under the old law, a unanimous agreement to vote to dissolve the corporation upon the happening of a stated contingency).

Close corporation practitioners have for some time resorted to the technique of incorporating in shareholders' agreements a provision that in the event of deadlock or other stated contingency all of the shareholders shall be obliged to vote their shares to effect a dissolution. The validity of such attempt to evade the deadlock statute or to provide for dissolution in terms that vary from existing statutory authorization is at least contentious under existing case law. Section 1105 resolves this controversy by authorizing such a dissolution expedient but only if the provision therefor is incorporated in the certificate of incorporation. The adoption of the statutory formula in section 1105 would seem preemptive and it is to be assumed that, after the effective date of the new business corporation law, the courts will not enforce the typical clause in a shareholders' agreement, unincorporated in the certificate of incorporation, which seeks to authorize corporate dissolution at will or upon a stated contingency.48

One authority has intimated that even a high vote requirement for dissolution must comply with section 1002.49 Such an interpretation may well be correct, since section 1001, the ordinary voluntary dissolution provision, expressly allows deviations from its terms only by a provision under the former section.50 This would mean that the special requirements of section 1002 must be complied with.51 If so, this would indicate an even greater preemption of the field by section 1002.

Although not completely without ambiguity, the Reviser's Comment52 tends to support Israels' position. Hopefully, it will be the one to prevail, at least where the shareholder agreement is unanimous. Undoubtedly, a "Beresovski clause"53 would not hurt.

However, the Department of State has indicated that it will accept a certificate of incorporation which provides that the specified event provoking dissolution under section 1002 will be an arbitrator's decision, or a judicial determination of breach of a shareholders' agreement.54 Since either of these events should prove sufficient for

§ 1002 (McKinney 1963). The change in language, which occurred after Professor Hoffman's article, would not seem to affect his comments.

51. N.Y. Bus. Corp. Law § 1002(b) (McKinney 1963) requires unanimous shareholder (voting and non-voting) approval for addition of the provision by certificate amendment, as well as for any change or deletion, unless a different proportion is specifically provided for in the certificate. Id. § 1002(c) requires conspicuous notice of the existence of the provision on each share certificate. This might (but hopefully will not be so interpreted) render a mere general reference to a high vote requirement (under § 616) for shareholder action insufficient notice.
52. "A shareholders' agreement for dissolution would probably be held valid in the absence of statutory recognition of its validity. Since such a provision must be in the certificate of incorporation by unanimous shareholder consent, its use would be feasible only in close corporations and the anticipated condition would normally be a state of deadlock or dissension. Thus the section supplies a useful supplement to § 1104." N.Y. Bus. Corp. Law § 1002, Comment (McKinney 1963).
53. See note 28 supra.
54. Letter of Glenn C. Relyea, Esq., Associate Attorney, Bureau of Corporations, State of
most close corporations, prudence dictates that one or the other of these provisions be added to the certificate to assure implementation of the shareholder agreement's dissolution arrangement, even though the agreement may be independently enforceable.

D. Voting Requirements

The Maryland statute allows a shareholder agreement to govern "[t]he exercise or division of voting power." This would seem to authorize not only "pooling agreements" (agreements as to how the shareholders will vote their shares), but also arrangements fixing quorum and voting requirements higher or lower than the normal statutory ones (for example, that certain actions must be approved by all the shareholders). It might even go further, and permit alteration of the normal voting power of shares (for example, giving a 25 percent shareholder a 50 percent vote). Pooling agreements are, of course, valid in New York under section 620(a). It would seem equally clear that alterations in normal per share voting powers will be invalid without an explicit certificate of incorporation provision on the subject, despite the existence of a section 620(b) provision.

The Business Corporation Law does not authorize a lower vote than that of a majority (or plurality in the case of election of directors). It does, however, allow the by-laws to fix a quorum of as few as one-third of the shares. It is not certain that a mere agreement will suffice where the statute requires a by-law provision, since the court of appeals has taken a strict view of what is required to constitute a by-law provision. However, low-vote provisions are ordinarily not wanted by close corporations. If any change in the statutory majority

---

56. Such an agreement was held invalid in Nickolopoulos v. Sarantis, 102 N.J. Eq. 585, 141 A. 792 (Ct. Err. & App. 1928).
57. N.Y. Bus. Corp. Law § 620(a) (McKinney 1963) is set forth at text accompanying note 7 supra.
58. N.Y. Bus. Corp. Law § 612(a) (McKinney 1963) provides: "Every shareholder of record shall be entitled at every meeting of shareholders to one vote for every share standing in his name on the record of shareholders, unless otherwise provided in the certificate of incorporation." See also N.Y. Bus. Corp. Law § 613 (McKinney 1963). An alteration in the voting power of shares is obviously not an interference with board power, but rather with shareholder power, and accordingly, not within the compass of § 620(b).
60. Id. § 608(b).
61. See Model, Roland & Co. v. Industrial Acoustics Co., 16 N.Y.2d 703, 209 N.E.2d 553, 261 N.Y.S.2d 896 (1965) (mem.) (holding that a mere resolution increasing the number of directors did not constitute an "amendment" of the by-laws).
rule norm is chosen, it is usually of the high-quorum, high-vote variety.

Before the enactment of statutory authorization for such super-majority provisions, it was expressly held that an agreement imposing such a requirement was unenforceable. Under section 616 and its predecessor, both of which expressly allow high vote and quorum requirements to be imposed by the certificate of incorporation, mere by-law provisions were held insufficient by the court of appeals. An appellate division decision under the predecessor statute also expressly held that an agreement would not suffice. Although a more recent appellate division decision, and the court of appeals in the Beresovski case, give indications of a change in attitude toward the validity of such agreements, it would seem wise to comply with the statutory requirements in this regard, since it can be done without great difficulty.

Thus, a shareholder agreement requiring the consent of all (or some other proportion greater than a majority) of the parties for all, or at least significant, management decisions (as well as fundamental organic changes) can be validated, once power has been transferred to the shareholders under section 620(b), by the addition of relatively easy to draft high vote and quorum provisions.

E. Employment

The Maryland statute also authorizes a shareholder agreement regarding "[t]he terms and conditions of the employment of any officer or employee regardless of the length of the period of such employment."
A corporation, of course, has the power to hire employees and appoint officers. Although certain earlier cases were to the contrary, it appears that even a long term employment contract is valid if approved by the board of directors. Furthermore, the Business Corporation Law expressly recognizes even contracts to employ persons as officers. Corporate contracts of the type authorized by the Maryland statute should, therefore, be valid.

The question remains, however, whether a shareholder agreement can accomplish this. Such agreements are common in New York, at least as to officer status. Shareholder agreements for election of officers and the fixing of their compensation are, however, director-intrusive, although probably valid if unanimous. However, section 715(b) provides:

The certificate of incorporation may provide that all officers or that specified officers shall be elected by the shareholders instead of by the board.

Thus by the simple expedient of inserting such a provision in the certificate of incorporation, agreements to vote to elect officers become, like the election of directors, no longer director-impinging, and the proper subject of a pooling agreement under section 620(a).

As to employment of non-officer personnel, there are at least two

---

70. See 1 F. O'Neal, Close Corporations § 6.06 (1971) and cases cited therein.
72. N.Y. Bus. Corp. Law § 716(b) (McKinney 1963).
73. See generally 1 F. O'Neal, Close Corporations §§ 5.18, 6.06 (1971).
74. See C. Israels, Corporate Practice 97, 483-84 (2d ed. 1969).
76. See Clark v. Dodge, 269 N.Y. 410, 199 N.E. 641 (1936). See also 3 White § 620.03[2], citing numerous lower court decisions predating enactment of the Business Corporation Law. "The majority of these cases have upheld shareholders' agreements entered into for the following purposes, at least in those instances in which all shareholders were parties to the agreement: (1) to elect or designate certain persons as officers (Agreements of this nature have uniformly been construed to imply that the designated persons are removable for cause.); (2) to fix salaries or compensation of officers; (3) to set tenure of officers. On the other hand, agreements for the following purposes have been held invalid: (1) to vest management of corporate affairs in shareholders; (2) to establish policy for distribution of dividends or assets. As indicated above, the courts have displayed a more liberal attitude towards the validity of shareholders' agreements since the Clark v. Dodge decision in 1936, but they have not consistently upheld restrictive agreements since that time." Id. § 620.03 at 461-62 (footnotes & emphasis omitted); Lubliner v. Sylu Knitting Mills, Inc., 213 N.Y.S.2d 726 (Sup. Ct. 1961) (holding that a unanimous shareholder agreement designating officers is valid, but will be construed to provide for continuation in office only so long as the officers remain faithful and efficient).
77. N.Y. Bus. Corp. Law § 715(b) (McKinney 1963). For a form of certificate of incorporation provision providing for election of officers by the shareholders, see 3 White Form No. 715:1.
long-standing decisions which indicate the validity of agreements to cause the hiring of such personnel even though the corporation is not a party, despite the intrusion on the board's management powers which such agreements represent. Therefore, it should follow a fortiori,

78. Miller v. Vanderlip, 285 N.Y. 116, 33 N.E.2d 51 (1941) involved an agreement between plaintiff and six other persons who, at the request of the majority (but not sole) shareholders, were to rehabilitate a floundering corporation. The court stated that even if it were assumed that defendants were shareholders (which the complaint did not allege) it would not be illegal for them to agree to advocate a plan which, inter alia, called for the hiring of plaintiff as president and general manager for a three year period at a stated salary and, accordingly, a cause of action for damages was stated against them for failure to do so. The court added: "The fact that plaintiff might not be eligible to be both president [since not a director, as then required] and general manager is no excuse for the failure of the defendants to urge the selection of plaintiff for the position of general manager, albeit in that event the remuneration of plaintiff probably would not have been the same as if he had occupied both positions." Id. at 124, 33 N.E.2d at 55.

In Cuppy v. Ward, 187 App. Div. 625, 176 N.Y.S. 233 (1st Dep't), aff'd mem., 227 N.Y. 603, 125 N.E. 915 (1919), plaintiff Cuppy and defendant Ward were the sole shareholders of the defendant Pennsylvania corporation, which was not expressly a party to the agreement between them. Although the court in a 3 to 2 decision (the "swing-man" concurring on the ground that a New York court should not interfere in the internal affairs of a foreign corporation), held that the complaint would not support the grant of a mandatory injunction restoring plaintiff to his position as a manager of the corporation. The court clearly recognized the plaintiff's right to damages for breach of the defendant's promise that plaintiff would be continued in the corporation's employ at a specified salary with certain powers, although the corporation was not a party, and, more importantly, indicated that it would go along with the dissent in approving equitable relief if the contract had been entered into as a part of the agreement to form the corporation. The court stated: "If he held a contract binding on the corporation to employ him for a definite time at a fixed compensation, and he was wrongfully discharged, he has a full and adequate remedy at law for damages. If his contract was not binding on the corporation, but Ward personally was obligated to him [in] so far as he was able to keep him in that position for a definite time at a fixed compensation, and Ward caused his discharge by making or instigating others to make false and untrue charges which caused him to lose his position, he also has a full and adequate remedy at law against Ward for damages." Id. at 628-29, 176 N.Y.S. at 236.

For a more recent case upholding a shareholder employment contract, see Samuelson v. Starr, 28 Misc. 2d 479, 481, 213 N.Y.S.2d 889, 891-92 (Sup. Ct. 1961) ("Such agreement by all of the stockholders of a corporation to vote for certain persons as directors and to continue a director as manager is not unlawful on its face and may be specifically enforced if there is no interference with the rights of creditors or minority stockholders.").

On the other hand, a recent second department decision refused to enforce such an employment agreement. In DeVecchi v. DeVecchi, 34 App. Div. 2d 790, 311 N.Y.S.2d 530 (2d Dep't 1970) (mem.), an apparently unanimous shareholder agreement provided that the parties' salaries as officers, directors or employees would be "fixed by the mutual consent of all the parties hereto." It was further agreed that any increases would require the unanimous consent of the shareholders. After being fixed at $125 per week, pursuant to the agreement, one party's salary was reduced, over his objection, to $50 a week. Although it could merely have held the agreement inapplicable, since a reduction rather than an increase in salary had taken place, the court chose to hold the agreement invalid, stating, "[i]n our opinion, those provisions of the stockholders' agreement requiring mutual and unanimous consent of all parties on fixation of salaries were mere agreements to agree in the future, unenforceable and not binding on appellants (Benintendi v. Kenton Hotel, 294 N.Y. 112, 120; St. Regis Paper Co. v. Hubbs & Hastings Paper Co., 235 N.Y. 30, 36)." Id., 311 N.Y.S.2d at 531.
that where a section 620(b) provision transfers board power to the shareholders there should be no doubt as to the validity of a contract hiring employees, if approved by the shareholders.79

While there is authority that otherwise valid shareholder agreements will be binding on the corporation without formal approval by it, validity should be absolutely assured as to both officers and employees by the corporation’s formal assent to the contract, and, accordingly, the shareholder agreement should add that they agree to cause the corporation to become a party to any agreement on the subject.80 In this way, by utilizing the two certificate of incorporation provisions, there should be no doubt as to the availability of the benefit afforded by the Maryland statute to New York corporations.

F. Directors and Officers

The Maryland statute expressly adds authorization for a shareholder agreement to determine who will be the directors and officers of the corporation.81 This is the least radical of its provisions. Agreements for the election of named directors have long been valid in New York,82 as well as other states,83 even without statutory authorization. They

The St. Regis Paper case did hold a price term in a contract for the sale of paper to be unenforceable, as an agreement to agree, where the price was to be fixed by mutual consent, and, accordingly, could have been the sole authority for the decision. The additional citation of Benintendi adds a further disturbing element, since that case held by-law provisions requiring unanimity for shareholder and director action invalid as in conflict with the statutory norm, and also refused to enforce the underlying shareholder agreement which similarly required consent of both (the only) shareholders to such action. The citation of both cases, therefore, indicates the erection of two hurdles which must be overcome before the validity of the arrangement can be achieved, at least in the second department. Fixing a definite dollar salary in the agreement, and requiring mutual consent to change it (the latter provision bulwarked by high vote requirements in the certificate of incorporation) would appear to be sufficient to get around this case.

That the corporation may be bound by a shareholder agreement even though not expressly a party, see Kolmer-Marcus, Inc. v. Winer, 32 App. Div. 2d 763, 300 N.Y.S.2d 952 (1st Dep’t 1969) (mem.), aff’d mem., 26 N.Y.2d 795, 257 N.E.2d 664, 309 N.Y.S.2d 220 (1970) (share transfer agreement); Weber v. Sidney, 19 App. Div. 2d 494, 244 N.Y.S.2d 228 (1st Dep’t 1963), aff’d mem., 14 N.Y.2d 929, 200 N.E.2d 867, 252 N.Y.S.2d 327 (1964) (agreement for division of profits); Siegel v. Ribak, 43 Misc. 2d 7, 249 N.Y.S.2d 903 (Sup. Ct. 1963) (arbitration agreement). See also In re Estate of Klaum, 58 Misc. 2d 262, 294 N.Y.S.2d 877 (Sur. Ct. 1968) (share transfer agreement; relying, however, on the fact that although the corporate officers did not sign the agreement it did bear the corporate seal).

79. See C. Israels, Corporate Practice app. B (2d ed. 1969) for a form of employment contract providing for, in each instance, shareholder approval as an alternative to board action in determination of duties, increases of compensation, dismissal, etc.
have now been expressly recognized by the Business Corporation Law. 84

The board is, however, not only superfluous to the average close corporation, but, because of the requirement of per capita voting, a definite impediment to its flexible functioning. Accordingly, it has been assumed throughout this Article that the board has been "sterilized" of power. As a result, the power to designate who will constitute the board is of little concern, although the shareholder agreement will normally provide for its membership.

As pointed out above, 85 unanimous shareholder agreements designating officers were upheld in New York even under its old statute, although the selection of officers is normally a directorial rather than shareholder function. With a certificate of incorporation provision allowing the shareholders to vote for officers, as authorized under section 715, there should be no doubt as to the validity of shareholder agreements designating officers, even without a section 620(b) provision.

G. Dividends

The Maryland statute allows a shareholder agreement to regulate "[t]he payment of dividends or division of profits." 86 It is hornbook law that the declaration of dividends is a matter ordinarily within the discretion of the board of directors. 87 This rule applies, of course, even to close corporations. 88

Accordingly, White points out that agreements to establish policy for distribution of dividends or assets were held invalid under the case law preceding the enactment of the Business Corporation Law, citing two early cases. 89 While the first case cited 90 is perhaps distinguishable on the ground that the agreement represented an attempt to treat the corporation as a joint venture, the second is clear in its statement of directorial power: "The directors are the only persons who can appro-

84. N.Y. Bus. Corp. Law § 620(a) (McKinney 1963).
85. See Part II(E) supra.
appropriate the earnings of the corporation either to the payment of dividends or to extension of plant.\footnote{91}

On the other hand, mandatory dividend provisions, where part of the individual shareholder's share contract with his corporation, are probably valid, provided they are restricted to funds legally available for their declaration, even though they clearly limit the director's discretion.\footnote{92}

Any fixed, or percentage, dividend guarantee might, however, be construed to be a "preference," making the shares benefited thereby a form of preferred stock. The shares would then be subject to the statutory requirements governing such stock, including the necessity for a certificate of incorporation provision detailing the rights given.\footnote{93}

Despite this, it must be remembered that one of the provisions of the shareholder agreement upheld in Clark v. Dodge\footnote{94} required that plaintiff "should during his life receive one-fourth of the net income of the corporations either by way of salary or dividends . . . ."\footnote{95} The agreement between the two sole stockholders was held to be not improperly restrictive of the powers of the board, and thus, specifically enforceable. The court added, however, that it would construe the division of profits provision "as meaning whatever was left for distribution after the directors had in good faith set aside whatever they deemed wise."\footnote{96}

\footnote{91. Cuppy v. Ward, 187 App. Div. 625, 630, 176 N.Y.S. 233, 237 (1st Dep't), aff'd mem., 227 N.Y. 603, 125 N.E. 915 (1919).}

\footnote{92. H. Ballantine, Corporations § 221, at 520 (rev. ed. 1946); Note, Mandatory Dividend Provisions in Shareholders' Contracts, 9 Syracuse L. Rev. 239, 248 (1958).}

\footnote{93. N.Y. Bus. Corp. Law § 501(a) (McKinney 1963). See also id. §§ 402(a)(5), 508(b).}

\footnote{94. 269 N.Y. 410, 199 N.E. 641 (1936).}

\footnote{95. Id. at 414, 199 N.E. at 642. The agreement further guarded against dissipation of those corporate earnings by continuing that "no unreasonable or incommensurate salaries should be paid to other officers or agents which would so reduce the net income as materially to affect Clark's profits." Id., 199 N.E.2d at 642.}

\footnote{96. Id. at 417, 199 N.E. at 643. See also Bernstein v. Esskay Waist Co., 176 N.Y.S. 94 (Sup. Ct. 1919), which involved an agreement among all (three) shareholders of a corporation providing for equal distribution among them of half of the corporation's profits, and retention of the balance which was "to be credited to the profit account of the respective parties . . . ." Id. at 95. On termination of the contract by mutual consent the court held that the retained profits were to be distributed in the same manner. It further specifically upheld the validity of the underlying agreement, stating: "Neither do I find in the law relating to corporations any reason why the intention of the parties in respect to such undistributed profits should not now be carried out. It is not proposed to impair the capital of the corporation as fixed in its certificate of incorporation, because it is only profits that the plaintiff is seeking his share of; nor, so far as appears in the
Thirteen years later, in *Christal v. Petry*, the court approved an agreement for equal monetary return despite disparate shareholdings—between the 51 percent and 44 percent shareholders—where the majority holder signed the letter agreement in his capacity as president of the corporation. The court, however, refused to enforce a less than unanimous agreement not to increase the number of directors.

More recently, the court of appeals, by affirming the appellate division in *Weber v. Sidney*, has reiterated its approval of unanimous agreements for the division of corporate profits, even in the absence of formal approval by the corporation itself. In that case, plaintiff and defendant, sole and equal shareholders, had a long-standing oral agreement for an equal division of earnings and profits so long as they remained owners of the defendant corporation. Although the appellate division stated that “[a]n agreement between stockholders for equal compensation from corporate earnings is not generally enforceable [sic] directly against the corporation which was not a party thereto,” it continued:

The plaintiff, however, within the framework of this action, is entitled to a declaration as to the validity and enforceability [sic] of the established agreement as between himself and the individual defendant Sidney. On abundance of authority, such an agreement is valid and binding upon the stockholders. Having chartered and followed year after year a course patterned on the existence of this particular agreement, the stockholder parties here are to be held to its terms. Certainly, the defendant Sidney, reaping and retaining over the years the advantages and benefits of the agreement, and, in fact, now holding corporate office and emoluments by virtue of the same, is not in a position to successfully challenge it. It may and should be enforced as against him and also as against the corporation, so far as is consistent with the due recognition of the corporate form.

While these cases indicate the independent validity in New York of the type of agreement on profit division authorized by the Maryland statute, a section 620(b) provision turning over director functions to the shareholders would obviously serve to overcome any lingering doubts based on directorial interference.

pleadings, will the rights of creditors or any other outsiders who may have had dealings with the corporation be impaired or in anywise affected.

“. . . [S]o long as its capital remains unimpaired and its creditors and others to whom it had obligations were not harmed, I cannot see why the agreement of the parties should not be carried out.” Id. at 95-96.


99. 19 App. Div. 2d at 498, 244 N.Y.S.2d at 232.

100. Id. at 498-99, 244 N.Y.S.2d at 233 (citations omitted).
H. Arbitration

The Maryland statute does not expressly deal with intracorporate arbitration agreements. This lacuna is filled by the Florida Close Corporation Law, which allows an agreement relating to, "[a]rbitration 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."\(^{101}\)

In an early New York decision,\(^{102}\) the court refused to reinstate a shareholder to his officer status even though he had been removed without submission of the matter to arbitration as required by his agreement with his co-shareholders, and established the principle that arbitration of director-level disputes is invalid. Although intervening lower court cases vacillated,\(^{103}\) not even the most recent court of appeals decisions have clearly repudiated this principle.\(^{104}\) On the other hand, it seems clear that disputes among shareholders in their shareholder capacities are arbitrable in New York when so provided in an agreement among them.\(^{105}\) If a section 620(b) provision transfers director power to the shareholders, all management disputes become shareholder disputes, and, accordingly, should be arbitrable under a shareholder agreement providing for this remedy. This will be true so long as shareholder consent is unanimous, even if the corporation is not (although it should be)\(^{106}\) a party to the agreement.\(^{107}\)

---

101. Fla. Stat. Ann. § 608.75(1)(g) (Supp. 1974). The Florida Statute has its own omission: it fails to authorize dissolution agreements. Furthermore, it should be noted that the arbitration authorization is undesirably limited to deadlock situations.


104. See Glekel v. Gluck, 30 N.Y.2d 589, 590, 224 N.E.2d 738, 728 N.Y.S.2d 236, 237 (1967), the latter affirming arbitration as not improper "when viewed against the factual background of the case," and the former reversing the appellate division's denial of arbitration on the ground that a director's agreement to "use his best efforts" was not a direct interference with the directors. But see Matter of Staklinski, 6 N.Y.2d 159, 160 N.E.2d 78, 188 N.Y.S.2d 541 (1959), upholding specific performance of an arbitral award of reinstatement of an employee under a contract between him and the corporation, despite the objection that this interfered with the board's management powers.

105. See N.Y. Bus. Corp. Law § 620(a) (McKinney 1963), set out at text accompanying note 7 supra. The provision for voting "in accordance with a procedure agreed upon by them," seems a clear acceptance of arbitration as such a procedure. And id. § 609(f)(5) expressly allows grant of an irrevocable proxy to "[a] person designated by or under an agreement under paragraph (a) of section 620," a clear authorization for implementation of the arbitrator's decision on how the shareholders should vote as such. See also Blum Folding Paper Box Co. v. Friedlander, 27 N.Y.2d 35, 261 N.E.2d 382, 313 N.Y.S.2d 375 (1970).


107. Siegel v. Ribak, 43 Misc. 2d 7, 13, 249 N.Y.S.2d 903, 909 (Sup. Ct. 1964) expressly held a shareholder agreement for arbitration of disputes between them to be enforceable even though the corporation was not itself a party. The holding in this regard seems clearly to have been
I. Summary

From the foregoing discussion it would appear that many of the same benefits obtainable under more modern statutes are available by unanimous shareholder agreement in New York. It is even clearer that transferring management to the shareholders under a section 620(b) provision, when coupled with other certificate of incorporation provisions as to shareholder election of officers, high vote, and dissolution tied to shareholder agreement events, will give even greater assurance of the availability of such benefits. Furthermore, if the entire arrangement is accorded the hoped for sympathetic judicial treatment, all of the benefits of the more modern close corporation laws may prove to be available.

III. Additional Matters

A. Informality

Transferring management to the shareholders, as section 620(b) appears to allow, also has other advantages. While the New York legislature has only recently amended the Business Corporation Law to provide for the substitution of unanimous written consent for a director's meeting,108 the same has long been true of informal action by shareholders. Section 615 expressly allows unanimous written shareholder consent to substitute for a meeting.109 Thus, if management is conferred upon the shareholders, the participants' informal, or even separate, consent to decisions can be validated in the same way approved by the court of appeals in its affirmance of Kolmer-Marcus, Inc. v. Winer, 32 App. Div. 2d 763, 300 N.Y.S.2d 952 (1st Dep't 1969) (mem.), aff'd mem., 26 N.Y.2d 795, 257 N.E.2d 664, 309 N.Y.S.2d 220 (1970). In the latter decision, the corporation was held bound by a share transfer agreement to which it was also not a party. See also Weber v. Sidney, 19 App. Div. 2d 494, 244 N.Y.S.2d 228 (1st Dep't 1963), aff'd mem., 14 N.Y.2d 929, 200 N.E.2d 867, 252 N.Y.S.2d 327 (1964).


109. N.Y. Bus. Corp. Law § 615(a) (McKinney 1963) provides: "Whenever under this chapter shareholders are required or permitted to take any action by vote, such action may be taken without a meeting on written consent, setting forth the action so taken, signed by the holders of all outstanding shares entitled to vote thereon. This paragraph shall not be construed to alter or modify the provisions of any section or any provision in a certificate of incorporation not inconsistent with this chapter under which the written consent of the holders of less than all outstanding shares is sufficient for corporate action."

The meaning of the last sentence is not completely clear. Israels interprets it to allow less than unanimous consent, even though authorized by the certificate of incorporation, only in situations where shareholder approval would not normally be required. C. Israels, Corporate Practice §§ 7.13, 9.37 (2d ed. 1969). Quaere whether it is applicable where management is transferred to the shareholders under a § 620(b) provision. It would, accordingly, seem unwise to rely on less than unanimous approval.
as under more permissive statutes—that is, by a simple signed approval of the transaction.\textsuperscript{110}

Obviously, then, execution of a formal shareholder consent to adoption of the shareholders' agreement by the corporation will be sufficient corporate action to make its provisions binding on the corporation. Thus, for example, persons designated in the agreement should be effectively employed by the corporation as officers and employees, and the corporation will at least be bound to arbitration of any dispute between it and the parties to the agreement.\textsuperscript{111}

Furthermore, it seems equally clear that such written consent can also be used to validate day-to-day management decisions agreed to by all of the shareholders.\textsuperscript{112} Even less formality than a section 615 consent, as to both the approval of the shareholder agreement and day-to-day management, may well be possible in the shareholder-managed corporation. Thus, Ballantine states: "Where all of the shareholders of a company make a unanimous agreement as to a corporate transaction, there is no necessity for any further formality, and the company will be bound by the unanimous agreement of its members, subject to possible rights of creditors."\textsuperscript{113} In an early case the New York Court of Appeals stated: "Certainly, what the stockholders might have done by the requisite vote, at a formal meeting, they might do by agreement between themselves, to which the assent of every one was obtained."\textsuperscript{114}

A more recent case, decided under the Business Corporation Law, also demonstrates that the requisite shareholder consent need not be expressed in any special form. \textit{Cross Properties, Inc. v. Brook Realty Co.}\textsuperscript{115} held that the minutes of a board of directors' meeting of the

\textsuperscript{110} Actually, even greater informality is possible, since the shareholders can give proxies to another person to execute the written consent. N.Y. Bus. Corp. Law § 609(a) (McKinney 1963). Only one state appears to authorize directors to vote by proxy. See La. Rev. Stat. Ann. § 12:81E (1969).

\textsuperscript{111} See N.Y. Bus. Corp. Law § 202(a)(2) (McKinney 1963).

\textsuperscript{112} Dickson, commenting on the Florida statute which expressly allows abolition of the board and transfer of management to the shareholders, raises a question as to whether the shareholders will vote in the normal shareholder manner (per share) or as directors (per capita) where management has been transferred to them. Dickson, The Florida Close Corporation Act: An Experiment That Failed, 21 U. Miami L. Rev. 842, 850 (1967). It would seem reasonably clear under the New York statute that they will vote as shareholders normally do. See N.Y. Bus. Corp. Law § 612(a) (McKinney 1963).

\textsuperscript{113} H. Ballantine, Corporations § 170, at 390-91 (rev. ed. 1946).

\textsuperscript{114} Elyea v. Lehigh Salt Mining Co., 169 N.Y. 29, 33, 61 N.E. 992, 992-93 (1901). See also Haff v. Long Island Fuel Corp., 233 App. Div. 117, 251 N.Y.S. 67 (2d Dep't 1931), upholding corporate notes given by the treasurer to whom the shareholders had confided management by their common consent.

parent corporation, approving the sale of substantially all of the assets of its wholly owned subsidiary, constituted a sufficient writing to comply with subdivision (a) of section 615, and, accordingly, that the consent required by section 909(a) had been given.\textsuperscript{116}

O'Neal states the rule on shareholder informality even more strongly than Ballantine:

The courts now generally hold also that all the shareholders may by acquiescence waive the requirement of a meeting and impliedly authorize corporate acts to be done without a meeting. Further, even if the requirement of a meeting is not waived, a gathering of the participants may be held to be a valid meeting though no special formalities are observed; the presence and participation of all shareholders or members are all that is necessary to constitute a valid meeting. The fact that minutes are not kept or resolutions recorded does not invalidate acts done or authorized at the meeting.\textsuperscript{117}

Again, there are New York cases in accord.\textsuperscript{118} Therefore, although it is wise to memorialize all "meetings" even though informally convened, or to have the action consented to in writing, a shareholder-managed corporation stands a good chance of successfully operating under its shareholder agreement without observing much of the usual corporate ritual.

B. Unanimity

Both the Maryland and Florida shareholder agreement provisions require that all of the shareholders be parties.\textsuperscript{119} The New York cases

\begin{itemize}
\item \textsuperscript{116} Id. at 202, 322 N.Y.S.2d at 782. It should be noted, however, that the strongest argument against the necessity for formal shareholder action is found in the cases which have held the corporation bound by shareholder agreements without any attempt at corporate adoption. See note 78 supra.
\item \textsuperscript{117} 2 F. O'Neal, Close Corporations § 8.03, at 7 (1971) (footnotes omitted).
\item \textsuperscript{118} In Sire Plan, Inc. v. Mintzer, 38 Misc. 2d 920, 922, 237 N.Y.S.2d 123, 127 (Sup. Ct. 1963), the court observed: "In the light of the fact that Davidson was the sole stockholder, his action in voting for the removal of the directors without causing defendant or the directors to call a special meeting for that purpose was a mere irregularity, which Davidson, as the only stockholder, could waive. The provisions of the by-law for the calling of a special meeting were intended for the benefit of the stockholders and may be waived by them if present at the meeting (5 Fletcher, Cyclopedia of Corporations, § 1999)."
\item \textsuperscript{119} See also N.Y. Bus. Corp. Law § 606 (McKinney 1963) as to waiver of notice by attendance at a meeting without protest. For other cases recognizing the validity of unanimous shareholder action without a formal meeting, see Annot., 51 A.L.R. 941 (1927). (New York cases appear to be in accord). It has been further held, following the general rule (18 C.J.S. Corporations § 554 (1939)), that no minutes of the meeting need be kept. Gale-Hasslacher Corp. v. Carmen Contracting Corp., 219 N.Y.S.2d 212, 216 (Sup. Ct. 1961). Although this rule appears to have been changed by N.Y. Bus. Corp. Law § 624(a) (McKinney 1963), it is by no means clear that failure to record the shareholders' concurrence will invalidate the action taken, provided it can be satisfactorily proved. See, e.g., W. Cary, Corporations 190 (4th ed. unabr. 1973) discussing failure to obtain shareholder approval where required by statute.
\end{itemize}
prior to the enactment of the Business Corporation Law involving agreements covering the same matters authorized by the Maryland and Florida statutes show that, while unanimity would not necessarily guarantee validity, lack of unanimity was almost certain to guarantee invalidity. Under the Business Corporation Law, it is theoretically possible that some agreements will be valid, even though less than all of the shareholders are parties to them. Thus, for example, a majority of the shareholders can undoubtedly select officers they agree upon if the certificate of incorporation confers upon them the power to elect officers, since an agreement by less than all of the shareholders to vote as shareholders is expressly made lawful. The same majority can even amend the certificate of incorporation to insert the necessary implementing provision.

Although an amendment to add a section 620(b) provision requires unanimous (even non-voting) shareholder consent, insertion of the provision in the original certificate only requires approval of “all the incorporators.” Normally only one person signs the certificate. Thus, if the sterilization takes the form of a transfer of board power to the shareholders, their less than unanimous agreement should suffice for all decisions properly within the scope of the directorial function—that is, most of the matters dealt with in the Maryland and Florida statutory provisions.

Since less than unanimous shareholder agreements pertaining to management matters can, therefore, be validated in New York, provided the certificate of incorporation contains the necessary authorizing language, New York law is arguably even more “liberal” than the more modern statutes on close corporations. The question is largely academic, however, since, as a practical matter, management agreements of the Maryland and Florida type will be feasible only where all of the shareholders are parties to the arrangement.

such a limitation. See also id. § 350 which expressly allows agreements restricting the power of directors by a mere majority. On the other hand, substitution of shareholder management for the board, like a N.Y. Bus. Corp. Law § 620(b) (McKinney 1963) provision, requires approval of all the incorporators, subscribers or shareholders. Del. Code Ann. tit. 8, § 351 (Supp. 1968). Anomalously, the Delaware certificate provision can be excised by a mere majority. N.Y. Bus. Corp. Law § 715(b) (McKinney 1963) allows the certificate of incorporation to provide for election of officers by the shareholders, rather than the directors.

120. N.Y. Bus. Corp. Law § 715(b) (McKinney 1963) allows the certificate of incorporation to provide for election of officers by the shareholders, rather than the directors.
121. Id. § 620(a) (McKinney Supp. 1973).
122. Id. § 803(a) (McKinney Supp. 1973). Only two-thirds of the shareholders (unless the certificate of incorporation provides specifically for a greater number) are required to insert a super-majority vote requirement. Thus, less than all can validate a unanimous consent requirement. Id. § 616(b) (McKinney 1963).
123. Id. § 620(b)(1) (McKinney 1963).
124. Id.
125. See id. § 401 (McKinney 1963).
In the first place, no sensible New York lawyer will insert the implementing certificate of incorporation provisions without approval of all participants, and the obvious condition for such approval will be participation in the benefits of the underlying agreement. Secondly, the effectiveness of the management arrangement ultimately demands that all participants be parties to it. This is obvious in the case of share transfer restrictions imposed by agreement, since these will only bind the parties and transferees with notice of them. The same reasoning would seem to apply if the agreement is to determine the conditions of dissolution.

If the uncertainty as to the enforceability of a mere agreement requiring consent of all the parties to corporate action results in the inclusion of high vote provisions in the certificate of incorporation, the benefit of any veto thereby given cannot be denied to a non-party to the agreement. As to matters which the agreement, once validated by a section 620(b) provision, would presumably control (for example, hiring of employees, selection of officers, and declaration of dividends) although only the holders of a majority of the shares were parties to the agreement, no corporation should be consciously set up with built-in dissension, since the fruits of discord are almost certain to be financial failure. In short, if the parties cannot all agree, at least in the beginning, they had best not incorporate at all.

The last reason for not undertaking a shareholder-managed corporation unless all participants are parties to the underlying agreement is to increase the likelihood of judicial enforcement of the arrangement.

As indicated above, while unanimity was not a complete guarantee of enforceability of agreements prior to the Business Corporation Law, the fact that there were outstanding non-party minority interests was a significant factor in denying validity. As also indicated, the scope of permissible agreement provisions, even with an implementing section 620(b) certificate provision, is not completely certain. The courts can be expected to lean toward invalidity if they feel imposition on the minority is present or likely. Just as under the old law, the fact that all participants approved should foster enforceability.

126. If the lawyer represents all of the initial participants, he has an obligation to disclose the effects of certificate provisions on the interests of all parties. Smith, Book Review, 43 Clev. B.J. 243, 244 n.5 (1972). If any participant is represented by his own attorney, the latter, of course, can be expected (if for no better reason than potential malpractice liability) to protect his client from acceptance of an arrangement conferring benefits from which he is excluded.


128. See, e.g., the hypertechnical interpretation given to N.Y. Bus. Corp. Law § 702(b) (McKinney 1963) by the court of appeals to protect a minority shareholder from imposition by the majority holder in Model, Roland & Co. v. Industrial Accoustics Co., 16 N.Y.2d 703, 209 N.E.2d 553, 261 N.Y.S.2d 896 (1965) (mem.).

129. The fact that there are no "outside" shareholders will also be important in securing
Accordingly, where, as will always be advisable in order to avoid later disagreement as to basics, the shareholder-managed corporation will be governed by an underlying shareholder agreement, all shareholders should be parties, as is required under the special Maryland and Florida statutes.

IV. DRAFTING THE PAPERS

From the above discussion the outline of the terms of the documents desirable for the shareholder-managed corporation should be clear. Although the by-laws should be so drafted that they contain no inconsistent provisions, the two most important documents are the underlying shareholder agreement and the implementing certificate of incorporation.

The unanimous shareholder agreement should include provisions as to the management of the corporation (including, if desired, conferring control over particular aspects of the business on certain participants), share transfer restrictions, voting (including matters on which unanimous concurrence will be required), election of officers, hiring of employees (including the shareholder-parties), profit distribution, dissolution, and arbitration of disputes among the parties; in short, all of the matters expressly authorized as subjects of shareholder agreements under the Maryland and Florida statutes.

Each agreement should be tailored to fit the needs of the particular clients. There is, however, no shortage of form models which can be modified for the purpose.\(^\text{130}\)

There are certain expressions which it seems wise to include. Thus, the Beresovski clause\(^\text{131}\) should be added, just in case the power delegation in the certificate is not sufficiently specific. There are also two phrases which seem to have an almost magical effect in New York. One is: “best efforts.” An agreement by the parties to use their “best efforts” to secure the agreed upon action seems to have a much greater chance of success than a naked promise to accomplish it. Another is: “faithful, loyal and efficient.” An employment arrangement where the employee’s or officer’s job is contingent upon his remaining “faithful, loyal and efficient,” seems to have a greater chance of

---

\(^{130}\) E.g., C. Israels, Corporate Practice app. A (2d ed. 1969) (shareholders’ agreements); id. app. B (employment agreements); 2 F. O’Neal, Close Corporations §§ 10.32-.36 (1971) (shareholders’ agreements). See also id. §§ 10.37-.40 (stock purchase agreements); id. § 10.44 (longterm employment contracts). Many of the charter and by-law provisions included in chapter 10 can also be modified for shareholder agreements. See R. Kessler, New York Close Corporations § 8.07 (1968). Many of the cases discussed above will also supply useful language.

\(^{131}\) See note 28 supra.
success than a simple promise to keep him on come what may.\textsuperscript{132} The most important document however, is the certificate of incorporation, whose provisions must provide the umbrella for any agreement.

The above discussion has indicated in a general fashion what certificate provisions might be desirable. It should now be possible to assemble them, using more specific language, into a tentative certificate of incorporation for a New York shareholder-managed close corporation.\textsuperscript{133}

\textsuperscript{132} See, e.g., Glekel v. Gluck, 30 N.Y.2d 93, 281 N.E.2d 171, 330 N.Y.S.2d 371 (1972) (agreement in which "best efforts" were required sustained); Clark v. Dodge, 269 N.Y. 410, 199 N.E. 641 (1936) (agreement which required manager to be "faithful, efficient, and competent" sustained). See also Fells v. Katz, 256 N.Y. 67, 175 N.E. 516 (1931) (denying plaintiff's claim where the employment contract only required "best efforts" and not that he be "faithful, efficient and competent"). But see McQuade v. Stoneham, 263 N.Y. 323, 189 N.E. 234 (1934) (agreement requiring "best endeavors" held not valid where not all shareholders were parties).

\textsuperscript{133} Such a certificate would at least include a § 620(b) provision transferring management from the board to the shareholders (see notes 30-34 supra and accompanying text), a provision for the election of officers by shareholders (see notes 81-85 supra and accompanying text), an appropriate dissolution provision (see notes 41-54 supra and accompanying text) and a high vote and quorum provision (see notes 55-67 supra and accompanying text). Among the leading articles which should be consulted as to the earlier New York cases are Delaney, The Corporate Director: Can His Hands Be Tied in Advance, 50 Colum. L. Rev. 52 (1950); Israels, The Close Corporation and The Law, 33 Cornell L.Q. 489 (1948); Meek, Employment of Corporate Executives by Majority Shareholders, 47 Yale L.J. 1079 (1938); Comment, "Shareholders' Agreements" and the Statutory Norm, 43 Cornell L.Q. 68 (1957).