California Law Review

MEMBER NATIONAL AND WESTERN CONFERENCES OF LAW REVIEWS

Published Five Times Yearly by Students of the School of Law of the University of California, Berkeley, California. Indexed in Index to Legal Periodicals and Public Affairs Information Service.

Subscription Price, $5.00 Current Single Copies, $1.50

Comment

RIGHTS OF THE MINORITY SHAREHOLDERS TO DISSOLVE THE CLOSELY HELD CORPORATION

A major problem confronting prospective shareholders of a closely held corporation[1] is that of devising effective measures to protect minority holders in the event of dissension. Desire for such protection may arise, for example, in a situation where business partners decide to incorporate to

[1] The characteristics of the "close corporation" or "chartered partnership" have been listed by Winer as follows: ". . . (1) the stockholders are few; (2) they know one another well; (3) most or all of them are active; (4) each of them assumes some affirmative obligations; (5) there is no ready market for their shares; (6) the identity of the other shareholders is

achieve limited liability[2] and to obtain possible tax advantages.[3] If partnership-like management[4] and profit sharing[5] arrangements are desired in the new business form, they can be retained through an appropriate distribution of voting[6] and non-voting shares.[7] The arrangement, however, will

important to each of them." Winer, *Proposing a New York "Close Corporation Law,"* 28 CORNELL L.Q. 313, 314 (1943). Israels, on the other hand, proposes a more generic definition. "In the economic sense in which the term is used in the United States, a 'close corporation' is an enterprise in corporate form in which management and ownership are substantially identical. As a result of that identity the participants consider themselves 'partners' and seek to conduct the corporate affairs to a greater or lesser extent in the manner of a partnership." Israels, *The Close Corporation and the Law,* 33 CORNELL L.Q. 488 (1948).

For general discussion of the closely held corporation see: BALLANTINE, CORPORATIONS 424 (rev. ed. 1946); ROHRLICH, LAW AND PRACTISE IN CORPORATE CONTROL 210 (1933); Cary, *How Illinois Corporations May Enjoy Partnership Advantages: Planning for the Closely Held Firm,* 48 NW. U. L. REV. 427 (1953); Cataldo, Gower, Hornstein, Kramer, Latty, Lowndes, O'Neal, Treillard, *The Close Corporation [a symposium],* 18 LAW & CONTEMP. PROB. 433 (1953); Delaney, *The Corporate Director: Can His Hands be Tied in Advance,* 50 COLUM. L. REV. 52 (1950); 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); Winer, *Proposing a New York "Close Corporation Law,"* 28 CORNELL L.Q. 313 (1943); Weiner, *Legislative Recognition of the Close Corporation,* 27 MICH. L. REV. 273 (1929).

[2] For the converse of this generally recognized advantage, see *In re* John Koke Co., Haese v. A. R. Demory Inv. Co., 38 F.2d 232 (9th Cir. 1930), *cert. denied,* 282 U.S. 840 (1930) (corporation not liable on "sole" shareholder's personal note secured by shares of the corporation).

[3] ROHRLICH, ORGANIZING CORPORATE AND OTHER BUSINESS ENTERPRISES 185 (rev. ed. 1953); 6 MERTENS, FEDERAL INCOME TAXATION § 35.01 (1949). The extent to which INT. REV. CODE OF 1954, § 1361 (allowing a proprietorship or partnership under certain circumstances to elect to be taxed as a corporation) makes it unnecessary to incorporate to obtain full tax advantages is not altogether clear. *Compare* Brown, *Unincorporated Business Enterprises Electing to be Taxed as Domestic Corporations—Section 1361,* 1955 SO. CALIF. TAX INST. 281, 304 (1955), *with* McNaughton, *To be Taxed as a Corporation,* 33 TAXES 253 (1955), and Moore, *Should Your Business be Taxed as a Corporation?, id.* at 258.

[4] UNIFORM PARTNERSHIP ACT § 18 provides: "The rights and duties of the partners in relation to the partnership shall be determined, subject to any agreement between them, by the following rules:

. . .

(e) All partners have equal rights in the management and conduct of the partnership business.

. . .

(h) Any difference arising as to ordinary matters connected with the partnership business may be decided by a majority of the partners; but no act in contravention of any agreement between the partners may be done rightfully without the consent of all the partners."

[5] Under UNIFORM PARTNERSHIP ACT § 18(a), in absence of agreement, the partners share equally in the profits and surplus. A further partnership attribute, ability to select associates ["No person can become a member of the partnership without the consent of all the partners," UNIFORM PARTNERSHIP ACT § 18(g)], has been successfully assimilated to the corporate form by placing restrictions on the alienation of shares. Bechtold v. Coleman Realty Company, 367 Pa. 208, 79 A.2d 661 (1951); BALLANTINE, CORPORATIONS 779 (rev. ed. 1946); Hornstein, *Stockholders' Agreements in the Closely Held Corporation,* 59 YALE L.J. 1040, 1047–1049 (1950); O'Neal, *Restrictions on Transfer of Stock in Closely Held Corporations: Planning and Drafting,* 65 HARV. L. REV. 773 (1952).

[6] In addition, many states allow or require cumulative voting: *e.g.,* CAL. CORP. CODE § 2235; DEL. GEN. CORP. LAW § 214. By cumulating his votes, a shareholder who owns or controls twenty-six per cent of the shares is assured election to a three director board. On the mechanical aspects of cumulative voting, see WILLIAMS, CUMULATIVE VOTING FOR DIRECTORS 40–46 (1951). See also: Bowes and DeBow, *Cumulative Voting at Elections of Directors of Corporations,* 21 MINN. L. REV. 351 (1937); Cole, *Legal and Mathematical Aspects of Cumulative Voting,* 2 S. C. L.Q. 225 (1950).

[7] Most statutes prescribe that corporate action can be effected by a majority of the board. CAL. CORP. CODE § 817; DEL. CODE ANN. tit. 8, § 141 (1953). For additional devices to assure

be deficient in one highly important aspect. If differences arise between the business associates, one may find that although he retains his interest in the business, the others, through control of the board, may terminate his employment and perhaps withhold dividends.[8]

Had the partnership form been retained, the ability of a partner to compel dissolution and distribution of his share of the net assets of the partnership[9] would have been an effective weapon to combat action by the other partners hostile to his interests.[10] However, when doing business in the corporate form, he may be confronted with a statute requiring votes of fifty per cent or more of the shareholders to effect voluntary dissolution.[11]

---

control over management, see Clark v. Dodge, 269 N.Y. 410, 199 N.E. 641 (1936); BALLANTINE, CORPORATIONS 416 (rev. ed. 1946); Delaney, *The Corporate Director: Can His Hands be Tied in Advance,* 50 COLUM. L. REV. 52 (1950).

[8] See Hyman v. Velsicol Corp., 342 Ill. App. 489, 97 N.E.2d 122 (1951) (dilution of minority interest). *But cf.* Burleson v. Hayutin, 273 P.2d 124 (Colo. 1954) (termination of employment and non-payment of dividends); Gaines v. Manufacturing Co., 234 N.C. 331, 67 S.E.2d 355 (1951) (dividends); Gaines v. Manufacturing Co., 234 N.C. 340, 67 S.E.2d 350 (1951) (pre-emptive rights).

[9] UNIFORM PARTNERSHIP ACT § 31; "Dissolution is caused: (1) Without violation of the agreement between the partners .... (b) By the express will of any partner when no definite term or particular undertaking is specified .... (2) In contravention of the agreement between the partners ... by the express will of any partner at any time ...."

[10] Other methods have been used in an effort to afford protection to minority shareholders.

Under some state statutes it is permissible to provide that corporate action can be taken only with the unanimous consent of the directors or shareholders, as the case may be. DEL. CODE ANN. tit. 8, § 141 (1953) (quorum for directors' meetings), § 216 (quorum for shareholders' meetings and votes necessary to transact business); ILL. REV. STAT. c. 32, § 157.31 (1953) (quorum for shareholders' meetings), § 157.37 (quorum and voting requirements for director action); N. Y. STOCK CORP. LAW § 9 (quorum and voting requirements for directors' and stockholders' meetings and for transaction of business).

Provisions have also been employed requiring a percentage vote in excess of that specified in the statutes to effect voluntary dissolution. Whether such agreements are more easily sustained than those permitting dissolution by fewer than the statutory number of shares seems unsettled. Leventhal v. Atlantic Finance Corp., 316 Mass. 194, 55 N.E.2d 20 (1944), held that MASS. GEN. LAWS c. 155, § 50, allowing a majority of the holders to file a dissolution petition, was permissive, therefore permitting effect to be given to a contract between the two shareholders precluding dissolution except under specified conditions. The distinction between restricting and expanding statutory dissolution power is pointed out by Hornstein, *Judicial Tolerance of the Incorporated Partnership,* 18 LAW & CONTEMP. PROB. 435, 448–449 (1953).

In extreme situations, it is clear that exercise of such veto provisions would lead to complete stalemate in corporate management. Some corporation statutes do provide a dissolution remedy in the event of deadlock, note 11 *infra.* However, under certain of these statutes, courts have denied the remedy where the corporation continues to be a successful business despite dissension. Matter of Radom & Niedorff, Inc., 307 N.Y. 1, 119 N.E.2d 563 (1954); Matter of Cantelmo (Brewer), 275 App. Div. 231, 88 N.Y.S.2d 604 (1st Dep't 1949). The proceedings may result in costly litigation.

Additional protection has been sought from use of long term employment contracts. The prevailing statutory requirement that the business of a corporation shall be managed by its board of directors makes such contracts vulnerable. Meck, *Employment of Corporate Executives by Majority Stockholders,* 47 YALE L.J. 1079, 1080 (1938).

[11] If the shares were owned by two holders or factions of equal interest, CAL. CORP. CODE § 4600, which provides for dissolution at the instance of fifty per cent or more of the voting power, would afford ample protection. Most statutes, however, require votes of over fifty per cent of the shares to dissolve voluntarily; note 17 *infra.* Voluntary dissolution may generally be accomplished through action by a specified majority of the shareholders, whereas under most statutes involuntary dissolution may be brought about by a minority of shares for specified

This requirement, coupled with the usually narrow market for closely held shares, may leave him virtually powerless against the majority shareholders. It is the purpose of this comment to determine whether shareholders may arrange for the same minority power to compel dissolution as exists in the partnership form of business.[12]

Assimilation of partnership characteristics to the closely held corporation is complicated primarily by the fact that American corporate statutes have generally been drafted to meet the business needs of public issue corporations, where ownership is widely diffused and management is centralized in a board of directors. Against the background of these statutes, some courts have shown hostility toward variations from the corporate norm[13] which are designed to permit shareholders to enjoy partnership advantages under the corporate form.

An argument frequently made against such variations is that limited liability should be purchased only at the expense of strict adherence to statutory requirements.[14] It has been held, for example, that the shareholders cannot, even by unanimous agreement, delegate management of the enterprise to one or more of the shareholder-directors, free from board supervision, but must retain substantial control over the business in the board of directors.[15]

The rationale of decisions which demand invariable conformity with

causes. The power to dissolve here proposed is involuntary in the sense of ultimate minority action, but it is more closely akin to voluntary dissolution since the power to dissolve would be originally created by majority consent. Also, to cause involuntary dissolution, minority shareholders must generally show waste or mismanagement, factors which are not necessary for exercise of the proposed power. Deadlock dissolution statutes commonly provide a remedy where there is an even number of directors or two or more factions of shareholders which are evenly divided and corporate affairs are at an impasse.

Most state statutes clearly differentiate between the various occasions which may give rise to dissolution; *e.g.*, CAL. CORP. CODE §§ 4600–4619 (voluntary proceedings), §§ 4650–4661 (involuntary proceedings, including deadlock situations), §§ 4690–4692 (proceeding by state); DEL. CODE ANN. tit. 8, § 275 (voluntary proceedings), § 283 (involuntary proceedings). For a discussion dealing primarily with involuntary dissolution problems, see Fain, *Limitations of the Statutory Power of Majority Stockholders to Dissolve a Corporation,* 25 HARV. L. REV. 677 (1912); Hornstein, *A Remedy for Corporate Abuse—Judicial Power to Wind Up a Corporation at the Suit of a Minority Stockholder,* 40 COLUM. L. REV. 220 (1940); Israels, *The Sacred Cow of Corporate Existence—Problems of Deadlock and Dissolution,* 19 U. CHI. L. REV. 778 (1952).

[12] *Cf.* Cary, *How Illinois Corporations May Enjoy Partnership Advantages: Planning for the Closely Held Firm,* 48 NW. U. L. REV. 427, 437 (1953).

[13] Ballantine lists the common corporate norms as "the principal advantages of the corporate form of business organization over the partnership . . . : (1) the capacity to hold property, to contract, to sue and be sued as a legal unit or distinct entity; (2) exemption of shareholders from personal liability; (3) continuity of existence in spite of death or changes of members; (4) transferability of shares; (5) centralized management under a board of directors; (6) standardized methods of organization, management and finance for the protection of shareholders and creditors under statutory regulation." BALLANTINE, CORPORATIONS 1 (rev. ed. 1946).

[14] Jackson v. Hooper, 76 N.J. Eq. 592, 75 Atl. 568 (1910) (agreement between the two shareholders to elect dummy directors and run the corporation as a partnership); Long Park, Inc. v. Trenton-New Brunswick Theatres Co., 297 N.Y. 174, 77 N.E.2d 633 (1948) (management contract "sterilized the board").

[15] Kennerson v. Burbank Amusement Co., Inc., 120 Cal.App.2d 157, 260 P.2d 823 (1953); Long Park, Inc. v. Trenton-New Brunswick Theatres Co., 297 N.Y. 174, 77 N.E.2d 633 (1948).

the "corporate norm" is not altogether clear. It may be thought that creditors will suffer if partnership attributes, such as the power to force dissolution, be extended to the shareholders of a closely held corporation. However, since corporations can be dissolved by various specified shareholder majorities, sometimes by only fifty per cent, a demand of unlimited liability in exchange for allowing dissolution by a minority seems questionable, unless the statutes necessarily permit no other result.[16]

The precise scope of those corporate statutes which state the percentage of votes necessary to effect voluntary dissolution[17] is not altogether clear. For example, Section 4600 of the California Corporation Code provides:

> Any corporation may elect to wind up its affairs and voluntarily dissolve by the vote or written consent of shareholders or members representing 50 percent or more of the voting power.

It is not certain whether such a statute provides the exclusive method of accomplishing voluntary dissolution or whether it is intended to be operative only in the absence of an agreement among shareholders,[18] embodied in the articles or elsewhere,[19] authorizing dissolution by a vote or written

---

[16] It is interesting to note the reaction of the New York Legislature to court invalidation of corporate bylaws containing veto provisions. Section 9 of the New York Stock Corporation Law, enacted in 1948, permitted provisions to be placed in certificates of incorporation such as had been held inoperative in bylaws in Benintendi v. Kenton Hotel, 294 N.Y. 112, 60 N.E.2d 829 (1945). Such piecemeal correction, though not as efficacious as a comprehensive close corporation law, is probably more likely to occur. For discussion of the problem see Winer, *Proposing a New York "Close Corporation Law,"* 28 CORNELL L.Q. 313 (1943); Israels, *The Close Corporation and the Law,* 33 CORNELL L.Q. 488 (1948); Note, 62 HARV. L. REV. 526 (1949).

An analogy can be drawn between the present effort to create corporations with partnership attributes and the earlier successful creation of corporation-like, common-law joint stock companies. See BALLANTINE, CORPORATIONS 13 (rev. ed. 1946).

[17] Examination of state statutes reveals lack of uniformity in the percentage of votes required to dissolve. DEL. CODE ANN. tit. 8, § 275 (1953) (two-thirds); IOWA CODE § 491.23 (1954) (unanimous or as per articles); ME. REV. STAT. c. 53, § 111 (1954) (per vote of stockholders); MASS. GEN. LAWS c. 155, § 50 (1932) (fifty per cent or per articles; see note 10 *supra* for interpretation of this section); MICH. COMP. LAWS § 450.67 (1948) (not less than two-thirds); N. J. REV. STAT. § 14:13-1 (1937) (two-thirds); NEW YORK GEN. CORP. LAW § 102 (majority); OHIO REV. CODE ANN. § 1701.86 (1953) (two-thirds or per articles, though less than a majority); PA. STAT. ANN. tit. 15, § 2852-1102 (1938) (majority); S. D. CODE § 11.0902 (1939) (not less than two-thirds); UNIFORM BUS. CORP. ACT § 50 (at least two-thirds).

[18] "It may well be, however, that such an arrangement [using the corporation as an instrumentality to carry out a partnership] would not extend to enable a minority shareholder to seek dissolution of the corporation . . . ." BALLANTINE, CORPORATIONS 424 (rev. ed. 1946). Professors Ballantine, Lattin and Jennings raise a doubt as to the legal effect of such provisions: "It is not clear whether the statutes of some states regulating dissolution may be varied by a shareholder's agreement. See CAL. CORP. CODE § 4600." CASES AND MATERIALS ON CORPORATIONS 477 n.1 (1953).

[19] In California, articles of incorporation apparently will not be accepted for filing by the Secretary of State where they provide a higher or lower percentage vote for dissolution than that prescribed by CAL. CORP. CODE § 4600. The Senior Counsel for the Office of the California Secretary of State has made the following observations with respect to provisions in the articles of incorporation of a California corporation varying the percentage vote by shareholders as to certain matters:

"In the absence of statutory authority the articles may never require a greater percentage of shareholder approval to validate or authorize a given act or procedure than the minimum approval required by statute nor may the articles authorize approval by a lesser percentage of

consent of shareholders representing less than fifty per cent of the voting power.[20] It has been said that "a directory [permissive] statute or provision is one which need not be complied with in order that the proceeding to which it pertains may be valid."[21] On the other hand, the maxim *expressio unius est exclusio alterius* (mention of one thing implies exclusion of another) would lead to the contrary conclusion.[22]

Corporation laws generally authorize inclusion of optional provisions in the articles or certificate of incorporation. A typical statute states that the articles may include any desired provisions and may impose " . . . any limitations and requirements . . . regulating the business and affairs of the corporation and the powers of the directors and shareholders in a manner not in conflict with law."[23] Such provisions do not answer the question

shareholder voting power than the minimum prescribed by statute. For instance, Section 4600 provides that any corporation may voluntarily elect to dissolve by the vote or written consent of shareholders holding 50 percent of the voting power. This statutory right may not be restricted by any provision in the articles purporting to require the vote or consent of more than 50 percent of the shareholder voting power to voluntarily dissolve, nor may that right be enlarged by authorizing an election to dissolve by less than 50 percent."

The writer further states that Section 4107, which specifies a class vote of "not less than two-thirds" of the shares for merger or consolidation, cannot be varied by provisions in the articles requiring a greater number of votes. ASPEY, SUGGESTIONS AND PRECAUTIONS IN DRAFTING ARTICLES OF INCORPORATION, ORGANIZING AND ADVISING SMALL BUSINESS ENTERPRISES 162, 172 (California State Bar Continuing Education Program, 1954).

These conclusions are supported solely by reasoning to the effect that since CAL. CORP. CODE § 3632 (amendment of articles) and § 3901 (sale of assets) " . . . expressly provide[d] that the articles may require a greater percentage of shareholder approval . . . than that otherwise required by statute . . . ," the absence of such provision in § 4107 (merger and consolidation) and §4600 (dissolution) precludes a requirement in the articles that either a greater or lesser number of votes he cast. But see note 20 *infra*. Despite the lack of authority for this position, it would seem more expeditious in California to deal with the problem in a shareholders' agreement rather than to attempt to compel through mandamus the filing of articles containing such provisions. "The Secretary of State is not concerned with the validity of such agreements [restricting transfer of shares] as between the parties, but he is concerned with the legal propriety of including such a provision in the articles." *Id.* at 173.

[20] Whether such an agreement would be specifically enforceable is subject to some question. *Cf.* Note, *The Validity of Stockholders' Voting Agreements in Illinois*, 3 U. CHI. L. REV. 640, 651 (1936).

Since the specified vote requirements for amendment of articles (§ 3632) and sale of corporate assets (§ 3900) may be varied by provision in the articles, it could be argued that in failing expressly to permit variance in the dissolution section, the California legislature intended the statute to be exclusive. On the other hand, a contrary conclusion can be reached by reasoning from the explicit language of section 4107, which states the required approval for merger or consolidation. "The agreement shall be approved by the vote of the holders of *not less* than two-thirds of the issued and outstanding shares . . . ." (Italics added). It would seem that if fifty per cent were intended to be the *minimum* vote permitting dissolution, the code writers would have used language as invariable of construction as that pertaining to merger or consolidation. *But see* note 19 *supra*.

[21] CRAWFORD, STATUTORY CONSTRUCTION 514 (1940).

[22] *Id.* at 334. The writer there emphasizes, however, that the maxim is to be used merely to assist in determining the intent of the legislature and should be narrowly applied.

[23] CAL. CORP. CODE § 305c; *Cf.* DEL. CODE ANN. tit. 8, § 102(b)(1) (1953). Speaking of provisions placed in certificates of incorporation pursuant to such statutes, the New York court has said they " . . . must limit, not increase, the powers of the corporation or those of its directors or stockholders." Ripin v. U.S. Woven Label Co., 205 N.Y. 442, 446, 98 N.E. 855, 856 (1912). In *Legislative Recognition of the Close Corporation*, 27 MICH. L. REV. 273 (1929), Weiner cites Matter of Boulevard Theatre & Realty Co., 195 App. Div. 518, 186 N.Y. Supp. 430

whether the dissolution statute is intended to be exclusive and, therefore, whether a provision specifying a different percentage vote would be "contrary to law."

Since under many state dissolution statutes there is considerable doubt whether effect would be given to a provision, in the articles or certificate of incorporation, authorizing less than the statutory percentage of voting power voluntarily to dissolve a corporation,[24] an independent agreement among all the shareholders to vote their shares for dissolution on specified conditions seems a more certain method of creating a minority dissolution power.[25] Concurrently, irrevocable proxies authorizing such vote might be given by the various shareholders, which proxies[26] should be deemed powers coupled with an interest given as security for performance of the contractual obligation.[27] On the other hand, such a provision could be included in a voting trust agreement;[28] or a certificate of election to wind up and dissolve meeting the statutory requirements[29] might be executed in advance.[30] Share and voting trust certificates should set forth the agreement and provide that transferees of the shares take subject to the contract.

From a rational viewpoint it would seem desirable to bolster the provision by incorporating it in all feasible instruments.[31] Failure of one means

(1st Dep't 1921), *aff'd*, 231 N.Y. 615, 132 N.E. 910 (1921) as exemplifying the problem. It was there held that provisions in the articles requiring a unanimous vote for director election were not authorized by the statute permitting variation in corporate charters since elsewhere in the code it was provided specifically that a plurality could elect the board.

[24] See note 19 *supra*.

[25] See Ringling Bros., Etc., Shows, Inc. v. Ringling, 29 Del. Ch. 610, 53 A.2d 441 (Sup. Ct. 1947); Smith v. S.F. & N.P. Ry. Co., 115 Cal. 584, 47 Pac. 582 (1897). *But cf.* CAHILL, FORMATION OF THE CORPORATION, ORGANIZING AND ADVISING SMALL BUSINESS ENTERPRISES 178, 209 n.96 (California State Bar Continuing Education Program, 1954), where it is suggested that a California shareholders' agreement is valid for a maximum period of only seven years. This conclusion apparently rests on the assumption that such agreements will be considered proxies.

[26] See CAL. CORP CODE §§ 2225–2229; DEL. CODE ANN. tit. 8, § 212 (1953). But the duration of a proxy to vote shares of a California corporation cannot exceed seven years. CAL. CORP. CODE § 2226.

[27] See Deibler v. The Chas. H. Elliot Co., 368 Pa. 267, 81 A.2d 557 (1951); Mulloney v. Black, 244 Mass. 391, 138 N.E. 584 (1923).

[28] CAL. CORP CODE §§ 2230, 2231; DEL. CODE ANN. tit. 8, § 218 (1953). A voting trust agreement requiring unanimous consent of the trustees to voluntarily dissolve the corporation was upheld in DeMarco v. Paramount Ice Corp., 102 N.Y.S.2d 692 (Sup. Ct. 1950). For speculation as to the relative likelihood of sustaining an agreement permitting dissolution by *fewer* than the statutory number of votes, see note 10 *supra*.

[29] Statutes commonly provide for dissolution upon the filing of a certificate evidencing the consent of a specified percentage of shareholders to such dissolution. CAL. CORP. CODE § 4603; DEL. CODE ANN. tit. 8, § 275(d) (1954).

[30] If, for example, four partners were incorporating, and each signed four certificates of election to wind up and dissolve, one certificate being retained by each, all that would remain necessary to initiate termination of the association would be filing with the secretary of state of the copy held by any one member. See CAL. CORP. CODE § 4603; DEL. CODE ANN. tit. 8, § 275(d) (1954).

It is possible that this arrangement might be attacked on the ground that the consents should be treated as proxies to vote for dissolution and, thus, subject to statutory restrictions limiting their duration.

[31] Though discussing only charter, bylaw and share certificate repositories, such an aggregating thesis is supported by O'Neal, *Giving Shareholders Power to Veto Corporate Decisions: Use of Special Charter and Bylaw Provisions*, 18 LAW & CONTEMP. PROB. 451 (1953). A similar

to accomplish the purpose of the agreement might, conceivably, be repaired by recourse to another.[32] Although it is not clear why the particular source of a contract should affect its ultimate validity, there is authority for the proposition that though provisions in the articles which vary statutory procedures will not be sustained, shareholder contracts to the same effect might be enforced *inter sese*.[33] Moreover, cases enforcing invalid corporate bylaws as contracts among the shareholders[34] suggest that such dissolution provisions might be given effect as contracts.[35]

---

suggestion is made with respect to arbitration provisions, O'Neal, *Resolving Disputes in Closely Held Corporations: Intra-Institutional Arbitration*, 67 HARV. L. REV. 786, 811 (1954) and share transfer agreements, O'Neal, *Restrictions on Transfer of Stock in Closely Held Corporations: Planning and Drafting*, 65 HARV. L. REV. 773, 785 (1952).

[32] See note 31 *supra*.

[33] Benintendi v. Kenton Hotel, 294 N.Y. 112, 121, 60 N.E.2d 829, 832 (1945) (dissenting opinion). An essentially contrary but seemingly more practical view is expressed in Ripin v. U.S. Woven Label Co., 205 N.Y. 442, 98 N.E. 855 (1912), where it was suggested that certificates of incorporation containing restrictive provisions should be sustained over comparable bylaws, since the former case would afford more protection to minority shareholders due to greater difficulty of amendment. *But cf.* note 19 *supra*.

In *In re* Peveril Gold Mines, Ltd., [1898] 1 Ch. 122, a motion was entered on behalf of two shareholders to stay proceedings upon a petition for the compulsory winding-up of the company. Movants sought relief under article provisions purportedly restricting petitioner's statutory power to compel dissolution. After declaring the article provision invalid, Lindley, M.R., added: "I do not intend to decide whether a valid contract may or may not be made between the company and an individual shareholder that he shall not petition for the winding up of the company." *Id.* at 131.

[34] Palmer v. Chamberlin, 191 F.2d 532 (5th Cir. 1951) (stock transfer restriction); Searles v. Banking & Trust Co., 128 Me. 34, 145 Atl. 391 (1929) (same); New England Trust Co. v. Abbott, 162 Mass. 148, 38 N.E. 432 (1894) (same); Annot., *Enforceability of Invalid Corporate Bylaw as Contract*, 159 A.L.R. 290; Note, *Corporations—Restriction Upon Transfer of Stock, While Not a Valid By-law Is Nonetheless Binding Upon the Parties as a Contract*, 38 VA. L. REV. 103 (1952).

[35] Similarly, courts might hold that a majority which previously consented to dissolution by minority vote has waived the provisions of a majority dissolution statute. Language is prevalent to the effect that rights, privileges, powers or immunities created by directory statutes for the benefit of individuals or classes, rather than for the public at large, may be waived by such benefited parties. Wells, Fargo & Co. v. Enright, 127 Cal. 669, 60 Pac. 439 (1900) (statute of limitations); French v. Teschemaker, 24 Cal. 518 (1864) (unlimited shareholder liability); Leventhal v. Atlantic Finance Corp., 316 Mass. 194, 55 N.E.2d 20 (1944) (right to dissolve); RKO Theatres v. Trenton-New Bruns. Theatres Co., 8 N.J. Super. 404, 414, 72 A.2d 914, 920 (1950) (Jayne, J.S.C.: "I have no doubt that one may ordinarily waive the benefits of a statutory remedy [dissolution] provided one does not thereby contravene the public policy exhibited by the enactment."); for general discussion demonstrating the availability of waiver, see 12 AM. JUR., *Contracts* § 166 (1938); Annot., 154 A.L.R. 269, 270 (1945).

Likewise, parties have been held estopped to assert rights, privileges, powers or immunities which have been waived or allowed to lapse in a premeditated transaction. Green v. Abietine Medical Co., 96 Cal. 322, 31 Pac. 100 (1892) (one-third holder estopped from claiming shares not fully paid where he had voted for their issuance as paid up shares); *but cf.* Martin v. Zellerbaeh, 38 Cal. 300 (1869) (estoppel cannot be invoked to effectuate illegal act, *viz.*, distribution of assets to shareholders on merger); Clearwater Citrus Growers' Assoc. v. Andrews, 81 Fla. 299, 87 So. 903 (1921) (former holders cannot be heard to claim use of statute they had specifically avoided using in prior attempt to dissolve corporation); Benintendi v. Kenton Hotel, 294 N.Y. 112, 60 N.E.2d 829 (1945) (dissenting opinion—though veto contract contravenes statute, parties thereto should be estopped to deny its validity).

"Where all the stockholders participate, the agreement should be enforced, regardless of the extent of deviation from the statutory norm. A disgruntled stockholder should not be permitted to wrap himself in the mantle of a defender of the statutory norm in order to evade obligations freely acquired." Delaney, *The Corporate Director: Can His Hands be Tied in Advance*, 50 COLUM. L. REV. 52, 66 (1950).

If minority dissolution agreements are placed in the articles or bylaws, provision should be made against their elimination by amendment.[36] This protection might be attained by stipulation in the articles that the provision cannot be amended by a vote of less than all the shares.[37] Where there is doubt as to the enforceability of such a restriction,[38] minority protection must be sought from one of the alternate devices suggested above.

Depending on local law, another technique may be available to incorporators desiring to provide in advance for minority dissolution. Since many statutes require dissolution on expiration of the corporation's charter,[39] a minority shareholder could achieve a rough substitute for dissolution power if a relatively short-lived corporation were created, with further provision for renewal of the charter only upon unanimous vote of the shareholders. A drawback to this plan is that a "partner" may desire withdrawal prior to the expiration of the period of existence. Furthermore, it has been held that where the prescribed vote for renewal of the charter could not be obtained, corporate existence could be effectively extended by utilizing the lower percentage vote required for sale of all the assets to another corporation.[40] This majority maneuver can be forestalled where statutes permit specification in the articles of a higher percentage vote of shareholders for effecting the sale of all assets.[41]

The short-term corporation device will also be precluded by statutes which declare a perpetual term of corporate existence,[42] or which make charter renewal possible by a particular vote, *e.g.*, of a majority of the shares,[43] private agreements to the contrary notwithstanding.[44]

---

[36] See Hornstein, *Judicial Tolerance of the Incorporated Partnership*, 18 LAW & CONTEMP. PROB. 435 (1953), considering the same drawback pertaining to short term corporations; and O'Neal, *Giving Shareholders Power to Veto Corporate Decisions: Use of Special Charter and Bylaw Provisions*, 18 LAW & CONTEMP. PROB. 451 (1953). *But see* note 19 *supra*.

[37] This is evidently possible under CAL. CORP. CODE § 3632, BALLANTINE AND STERLING, CALIFORNIA CORPORATION LAWS 379 (1949); and see Sellers v. Joseph Bancroft and Sons Co., 23 Del. Ch. 13, 2 A.2d 108 (Ch. 1938); Note, *Limitations on the Amending Power in the Corporate Contract*, 18 U. CHI. L. REV. 139 (1950).

[38] See Warren v. 536 Broad St. Corp., 6 N.J. Super. 170, 70 A.2d 782 (1950).

[39] See CAL. CORP. CODE § 4602; DEL. CODE ANN. tit. 8, § 278 (1954); MASS. GEN. LAWS c. 155, § 51 (1932).

[40] Porter v. C. O. Porter Mach'ry Co., 336 Mich. 437, 58 N.W.2d 135 (1953).

[41] MICH. COMP. LAWS § 450.57 (1948), as amended, MICH. STAT. ANN. § 21.57 (1951).

[42] This is apparently the case in California under CAL. CORP. CODE § 308 providing for perpetual existence unless otherwise provided by law; no other governing statutes having been discovered. Ballantine and Sterling, after reaching the same conclusion, add: "There is now no occasion for reduction of the term of existence because dissolution of a corporation and winding up of its affairs may be authorized by holders of shares representing 50 percent or more of the voting power, under Corp. C. 4600." BALLANTINE AND STERLING, CALIFORNIA CORPORATION LAWS, n.51, 393 (1949).

Many states afford greater flexibility by permitting the period of existence, which may be perpetual, to be determined by the articles of incorporation. DEL. CODE ANN. tit. 8, § 122 (1954); MD. ANN. CODE GEN. LAWS art. 23 § 450.12 (1951); MICH. COMP. LAWS § 450.12 (1948); N.Y. GEN. CORP. LAW § 14.

[43] IOWA CODE § 491.24 (1954); N.Y. GEN. CORP. LAW § 45. See Robbins v. Beatty, 67 N.W. 2d 12 (Iowa 1954).

[44] Although language this restrictive has not been found in the statutes, the question of

There is authority sustaining unanimous shareholder agreements calling for dissolution on certain contingencies. Thus, in an early federal case,[45] a corporation had been formed and a contemporaneous shareholder agreement executed providing that forty-nine per cent of the shares would be issued to the plaintiff, inventor of a machine to be used in the business. The remaining shares were to be issued to defendant financiers, who would contribute cash. The corporation was to be dissolved after one year if a *majority* of the board determined that the stock "was not a paying investment." If so dissolved, the machine was to be distributed to the plaintiff and the other corporate assets to the defendants. The plaintiff repudiated the contract by bringing suit to enjoin liquidation on the ground that the state statute, which provided that "no corporation [could] be dissolved by the members . . . except by consent of *two-thirds* of all . . . ,"[46] was exclusive.

Even though less than two-thirds of the shareholders presently favored termination of the enterprise, the court refused to enjoin dissolution, stating:

> [A]lthough the statutes of Nebraska provided ways and means for working the dissolution of a corporation, an agreement, signed by all the stockholders was valid *inter sese* . . . . The owners of property can make any contract for its disposal not forbidden by law, or against public policy or good morals.[47]

New York lower courts have upheld minority dissolution powers in at least two instances[48] and in several others have indicated by dicta that such agreements would be sustained.[49] *Matter of Block*[50] gave effect to a contract entered into by four brothers, holders of all the stock in a family corporation. The agreement provided that in the event the personal representative of a deceased shareholder could not dispose of decedent's shares in a specified manner, " . . . then at the option of the . . . personal representative . . . the corporation shall be forthwith dissolved . . . ." The court dismissed a petition to remove certain trustee shareholders who had voted for dissolution upon exercise of this option by a personal representative, holding their action proper in view of the contractual mandate.

Assuming the courts will enforce a dissolution provision, some may feel that such a device has practical shortcomings. It might be argued, for ex-

interpretation of pertinent code provisions as mandatory or directory remains to plague those desiring deviation from specified percentage vote requirements. Hornstein considers the problem in *Judicial Tolerance of the Incorporated Partnership,* 18 LAW & CONTEMP. PROB. 435, 449 (1953).

[45] Fish v. Nebraska City Barb-Wire Fence Co., 25 Fed. 795 (C.C.D. Nebr. 1885).

[46] NEB. COMP. LAWS c. 16, § 134 (1881); NEB. COMP. STAT. c. 16, § 134 (1885) (same) (italics added). Although not cited in the opinion, these sections appear clearly applicable.

[47] Fish v. Nebraska City Barb-Wire Fence Co., 25 Fed. 795, 796 (C.C.D. Neb. 1885).

[48] Application of Hega Knitting Mills, 124 N.Y.S.2d 115 (Sup. Ct. 1953); Matter of Block, 186 Misc. 945, 60 N.Y.S.2d 639 (1946).

[49] See, *e.g.,* Godley v. Crandall & Godley Co., 212 N.Y. 121, 105 N.E. 818 (1914) (improper motive); St. John of Vizzini v. Cavallo, 134 Misc. 152, 234 N.Y. Supp. 683 (1929) (statute permissive).

[50] 186 Misc. 945, 60 N.Y.S.2d 639 (1946).

ample, that a business which can be dissolved at the instance of a minority shareholder is rendered unstable. However, dissolution power is an essential feature of existing *partnership* businesses[51] and is in harmony with that policy of the law which provides an outlet for dissatisfied participants in a close personal association.[52]

Moreover, the shareholder contract might include specific provisions designed to protect the majority against an unfair forced liquidation. Thus, a shareholder could be required to offer his shares to the remaining "partners" at a price determined by specified valuation procedures prior to forcing dissolution.[53] He might also be compelled to submit a dispute to arbitration before exercising the power to dissolve.[54]

It should be possible today to create the power in a minority shareholder to dissolve a closely held corporation. Since such a power would enable the minority holder to protect himself against majority abuse, courts should view the device with favor and thereby greatly stimulate the use of the incorporated partnership by small business groups.

Edward M. Ford Jr.

---

[51] See note 9 *supra.*

[52] See CAL. CORP. CODE § 4651, note 11 *supra.*

[53] *Cf.* CAL. CORP. CODE §§ 4658, 4659 (involuntary proceedings); and see Cary, *How Illinois Corporations May Enjoy Partnership Advantages: Planning for the Closely Held Firm,* 48 NW. U. L. REV. 427 (1953); Israels, *The Sacred Cow of Corporate Existence—Problems of Deadlock and Dissolution,* 19 U. CHI. L. REV. 778 (1952). For discussion of valuation techniques see O'Neil, *Restrictions on Transfer of Stock in Closely Held Corporations: Planning and Drafting,* 65 HARV. L. REV. 773, 797 (1952).

[54] Ringling Bros., Etc., Shows, Inc. v. Ringling, 29 Del. Ch. 610, 53 A.2d 441 (Sup. Ct. 1947) (arbitration contract enforced); Application of Hega Knitting Mills, 124 N.Y.S.2d 115 (Sup. Ct. 1953) (same); O'Neil, *Resolving Disputes in Closely Held Corporations: Intra-Institutional Arbitration,* 67 HARV. L. REV. 786 (1954).