1970

Some Specific Needs of the Close Corporation Not Met under the Minnesota Business Corporation Act: Suggestions for Statutory Relief

Minn. L. Rev. Editorial Board

Follow this and additional works at: https://scholarship.law.umn.edu/mlr

Part of the Law Commons

Recommended Citation
https://scholarship.law.umn.edu/mlr/2968

This Article is brought to you for free and open access by the University of Minnesota Law School. It has been accepted for inclusion in Minnesota Law Review collection by an authorized administrator of the Scholarship Repository. For more information, please contact lenzx009@umn.edu.
Some Specific Needs Of the Close Corporation Not Met Under the Minnesota Business Corporation Act: Suggestions for Statutory Relief

I. INTRODUCTION

In recent decades, the close corporation has become an increasingly prevalent way of doing business, until today it is the most common form of corporate enterprise in the United States.1

1. Defining the term “close corporation” has proved a problem to scholars, judges and legislators. For an extended discussion of the several definitions in common use see 1 F. O’Neal, CLOSE CORPORATIONS § 1.02, at 2 (1958). As Professor O’Neal points out, the most popular definitions merely attempt to distinguish the corporation with relatively few shareholders from the publicly held corporation. Thus the close corporation is often defined as a company with only a few shareholders, or a corporation whose shares are not generally traded on the securities market. Some scholars, however, recognizing that a great majority of American corporations possess these characteristics, have attempted to further refine and limit the scope of the term “close corporation.” Some, for example, emphasize the partnership nature of the close corporation, defining it as one in which management and ownership coalesce.

Statutory definitional attempts in the past have, for the most part, adopted these popular definitions. Often states make the advantages of close corporation legislation available only to the corporation whose “[shares are not] listed on a national securities exchange or regularly quoted in an over-the-counter market by one or more members of a national or an affiliated securities association . . . .” N.Y. Bus. Corp. Law § 630(a) (McKinney Supp. 1969). See also S.C. CODE ANN. §§ 12-16.22(c), 12-22.14(b) (Supp. 1967); FLA. STAT. ANN. § 608.0100(2) (Supp. 1967); N.C. GEN. STAT. § 55-73(b) (1965). Several legislatures, however, have adopted more limiting provisions in an attempt to restrict access to the advantages of close corporation legislation. The most specific statutory definition is found in Delaware’s General Corporation Law, which has three requirements:

(1) All of the corporation’s issued stock of all classes, exclusive of treasury shares, shall be held of record by not more than a specified number of persons, not exceeding thirty; and
(2) All of the issued stock of all classes shall be subject to one or more of the restrictions on transfer permitted by section 202 of this title; and
(3) The corporation shall make no offering of any of its stock which would constitute a “public offering” within the meaning of the United States Securities Act of 1933 as it may be amended from time to time.

Del. CODE ANN. tit. 8, § 342(a) (1967). This definition is discussed in detail in Note, Delaware’s Close Corporation Statute, 63 NW. U.L. REV. 230 (1968).

For the purposes of this note, a close corporation is a corporation which has relatively few shareholders, whose shareholders are active in the management of the business and whose shares are not generally traded on the market. For a suggested statutory definition for the Minnesota Business Corporation Act, see note 60, infra.

2. Tennery, The Potential of the Close Corporation: A Question
It has been employed to achieve the ends of enterprises ranging in size from the ordinary family business to the Ford Motor empire.\(^3\) The universal acceptance of the close corporation as a business concept has, however, far outdistanced any concomitant development of applicable legal concepts. Since many legislatures have failed to distinguish the close corporation from its publicly held counterpart, the owners of a closely held corporation—who still view themselves essentially as partners—must conduct their business in conformity with statutory norms created for the widely held corporation. Many of these norms are clearly burdensome to the owners of a close corporation, and considerable imagination and ingenuity has been required to substitute advantageous partnership characteristics.\(^4\) For example, free transferability of shares is just as repugnant to the owners of a close corporation as is free transferability of partnership interests to a partnership. Thus in order to preserve the shareholders' right to determine with whom they will be associated in business, the close corporation often restricts the transferability of its shares.\(^5\) Another problem results from the fact that the investment of all shareholders is, in effect, locked into the close corporation.\(^6\) Due to this difficulty, the traditional corporate concept of majority rule is intolerable to minority shareholders, and all participants are often given a veto power over corporate actions.\(^7\) With this veto power, however, comes an appreciably greater possibility of corporate deadlock, making agreements relating to arbitration, buy-outs or dissolution a practical necessity.\(^8\)

Among the devices used to secure the advantages of a partnership are preincorporation agreements, special clauses in the charter and bylaws, restrictions on the transfer of shares, pool-
ing agreements, voting trusts and irrevocable proxies. There are, however, many inherent dangers in using these devices. Any agreement contravening established corporate norms is always of doubtful enforceability, and attempts designed to give partnership attributes to close corporations have at times been rejected by courts. Such rejection is generally premised upon the supposed illegitimacy of any attempt to obtain simultaneously the best of both the corporate and partnership worlds. This view was expressed by one court as follows:

The law never contemplated that persons engaged in business as partners may incorporate, with the intent to obtain the advantages and immunities of a corporate form and then, Proteus-like, become at will a copartnership or a corporation, as the exigencies or purpose of their joint enterprise may from time to time require.

This judicial attitude, in conjunction with the failure of legislatures to enact realistic schemes for the close corporation, has received increasing criticism from a host of commentators. The critics point out that businessmen’s legitimate needs find ex-

10. See parts IIA, IIC & IID infra.
12. Jackson v. Hooper, 76 N.J. Eq. 592, 599, 75 A. 568, 571 (Ct. Err. & App. 1910). In this case the two sole shareholders of a corporation agreed in an elaborate writing that the enterprise was to be operated in all respects as a partnership with both shareholders exercising equal voice in the management. In deference to the statute, the shareholders elected three other “dummy” directors who were to have no authority other than to vote as directed by the shareholders acting jointly. When a disagreement ensued between the shareholders, the “dummy” directors chose to vote with one of the shareholders against the other in contravention of the agreement. The court found the agreement illegal and unenforceable, holding that the rights of the shareholders must be administered as shareholders in the corporation, not as partners.
13. E.g., Winer, Proposing a New York “Close Corporation Law,” 28 CORNELL L.Q. 313 (1943); Oppenheim, The Close Corporation in California—Necessity of Separate Treatment, 12 HAST. L.J. 227 (1961); Powers, Cross Fire on the Close Corporation: Norms Versus Needs, 11 FLA. L. Rev. 433, 473 (1958); Note, Statutory Assistance for Closely Held Corporations, 71 HARV. L. Rev. 1498 (1958); Note, supra note 9. In an afterword to the last cited student note, Miguel A. de Capriles, Associate Dean, New York University School of Law, commented that “as a matter of public policy, there is no justification for a formalistic—perhaps one might say, sadistic—insistence upon an unnecessary and unsuitable internal structure or operational organization as a condition of limited liability in the close corporation. . . . To resolve these problems by the enactment of a special close corporation statute would in my judgment be in the public interest.” 33 N.Y.U.L. Rev. 743, 745 (1958).
pression in the close corporation, and there is no reason why traditional corporate norms should be considered sacrosanct. As long as all shareholders are in agreement and there is no injury to outsiders, there is no logic in hindering greater flexibility in the internal government of a corporation.

These arguments have not been without effect. In recent years, many courts and some legislatures have become more cognizant of the special nature of the close corporation. For example, some courts have gradually come to recognize the fundamental differences between close and publicly held corporations and have begun to apply different rules to each. Similarly, several state legislatures have made substantial attempts to provide relief for the close corporation. The Minnesota legislature has not been oblivious to the close corporation and several provisions of the Minnesota Business Corporation Act deal directly with its specific, practical needs. There are, however, many essential needs of the close corporation which are not met under the Minnesota act.

The purpose of this Note is to determine the deficiencies of the Minnesota Business Corporation Act in respect to the close corporation, examine the current statutory reforms of other states, and, in light of these reforms, suggest specific reforms of the Minnesota act.

II. VETO THROUGH GREATER THAN MAJORITY VOTING REQUIREMENTS

A. BACKGROUND

As previously noted, the participants in a close corporation

16. See, e.g., Galler v. Galler, 32 Ill. 2d 16, 203 N.E.2d 577 (1965). For a discussion of several other cases illustrating this change of attitude, see 1 F. O'Neal, supra note 1, § 1.15, at 31-32 (1958).
18. See, e.g., Minn. Stat. § 301.28(7) (1967), which allows action by the directors without a meeting, and Minn. Stat. § 301.28(1) (1967), which allows fewer than the traditional requirement of at least three directors.
commonly think of themselves as partners. In order for the minority shareholders of a close corporation to realize their expectations in the enterprise, it is often as essential to them as it is to the minority interests in a partnership to obtain a veto power over corporate decisions.\textsuperscript{19} The scope of such a power depends upon the needs of the particular shareholders. It may cover only major corporate matters, such as decisions relating to amendment of articles, sale of assets, merger, or capital reduction, or it may cover all corporate policy—even the day-to-day decisions concerning the operation of the enterprise. Since the incorporators usually expect to become directors or officers, they may be especially interested in obtaining veto power over duties, salaries and removal of directors and officers. Obviously, every shareholder would like the power to prevent his own removal as a director or officer, or a salary reduction for his office. On the other hand, those participants putting up the bulk of the capital will usually want a veto power over salary increases, dividend payments, the purchase or retirement of stock, and the creation of indebtedness.\textsuperscript{20} Veto power is especially crucial where there are restrictions placed on the transfer of shares, as is the norm in close corporations,\textsuperscript{21} since only with great difficulty can a minority shareholder withdraw from the corporation by selling his shares.\textsuperscript{22}

Despite the utility of, and often the necessity for, agreements relating to higher voting requirements for director and shareholder action, the validity of such agreements is open to question under many general incorporation statutes. Such agreements may be found to: (1) run counter to provisions specifying the requisite plurality for corporate actions;\textsuperscript{23} (2) contravene the traditional form of corporate management,\textsuperscript{24} or (3) violate public policy by making the conduct of corporate business difficult

\begin{itemize}
\item \textsuperscript{19} Partners may provide for veto power. See Uniform Partnership Act § 18 (1914).
\item \textsuperscript{21} See part II B infra.
\item \textsuperscript{22} 1 F. O'Neal, supra note 1, § 4.33, at 190–91 (1958). It should also be noted that minority interests without veto power are particularly susceptible to squeeze-outs at disadvantageous terms.
\item \textsuperscript{24} See, e.g., Jackson v. Hooper, 76 N.J. Eq. 592, 75 A. 568, 571 (Ct. Err. & App. 1910).
\end{itemize}
Many states, however, have legislatively approved greater-than-majority voting requirements at both shareholder and director levels. For example, the Model Business Corporation Act provides that the articles of incorporation are controlling whenever they require a greater shareholder vote than required by statute.26 Similarly, with respect to board action, the Model Act provides that a majority vote controls unless a greater number is required by the articles or bylaws.27 Similar provisions can be found in the New Jersey28 and Delaware29 statutes.

B. MINNESOTA LAW

Minnesota's corporation act is silent on greater-than-majority voting requirements for actions by the board of directors. In regard to shareholder action, the act has no general provision validating greater-than-majority requirements, but does provide for such in specified shareholder actions—specifically, for actions relating to amendment of the articles of incorporation,30 sale of assets,31 merger,32 and stated capital reduction.33 Although there is nothing in the act prohibiting greater-than-majority requirements for other actions, there is serious question whether such a requirement would be allowed for acts other than those specifically authorized by the statute.34

Under present Minnesota law, however, there are other means by which a minority shareholder or director can obtain a certain amount of veto power. Employment security can be partially satisfied through a long term employment contract. Since the Minnesota act allows nonvoting stock,35 veto power can be obtained through the classification of shares into voting and nonvoting stock as long as there are fewer than three share-

---

27. Id. § 37.
29. DEL. CODE ANN. tit. 8, § 216 (1967).
30. MINN. STAT. § 301.37 (1967).
31. Id. § 301.36.
32. Id. § 301.42(2).
33. Id. § 301.39(2).
34. Although this point has never been decided by the Minnesota Supreme Court, the court could easily find that, since the legislature validated greater-than-majority requirements only for the specified shareholder actions, it must have intended to disapprove such requirements for all other actions.
35. MINN. STAT. § 301.14 (1967).
holders. Voting shares could be distributed in such a way as to be given a balance of voting power and thus a veto. Further, in view of the Minnesota Supreme Court's liberal attitude toward shareholder-management agreements, such devices can presumably provide some veto power.

Finally, it may be possible to obtain some veto power through those provisions of the act allowing high quorum requirements at both shareholder and director levels. It is clear, however, that these provisions cannot provide a dependable veto power, since the courts would be reluctant to allow a shareholder to consistently veto corporate actions simply by boycotting meetings. Even if the practice were allowed, the dissenting shareholder would have to boycott all meetings since he will not always know in advance what will be brought up at a meeting. The result would be that no corporate business could be transacted.

C. PROPOSED REFORM

Although a certain measure of veto power can be obtained through the devices previously discussed, they are inadequate to fulfill the needs of the dissenting shareholder. Clearly the Minnesota legislature should protect minority interests in a close corporation through the adoption of a general provision, similar to the Model Act provisions validating greater-than-majority voting requirements. Further, such a provision should specifically allow the stockholders to provide for a requirement of unanimity, thereby avoiding any possible ambiguity. In addition, to protect outsiders, the statute should provide that the requirement will not bind a transferee unless he has actual notice thereof or notice of the provision appears conspicuously on the individual shares.  

36. Note that in order to make this device effective, care should be taken to give each class a veto power over reclassification. An alternative device would be to divide the shares into classes of voting stock and require voting by classes. In addition to being very cumbersome, a major drawback of these devices is that subchapter S election is lost under each. See INT. REV. CODE of 1954, § 1371.
37. See part IID infra.
38. MNN. STAT. § 301.25(7) (1967).
39. Id. § 301.25(6).
40. See notes 26 & 27 supra.
41. Note, supra note 13, at 1508. Shareholders, however, who have acquiesced in the provision should be bound by it even though it was not properly published and the shareholder was unaware of it at the time.
Finally, a provision validating greater-than-majority requirements need not be limited to the close corporation. To be sure, the risks of deadlock and dissolution are significantly higher where there are greater-than-majority requirements, but, as one commentator writes, "these risks... should be a matter solely for the judgment of the shareholders; they should not be a matter of paternalistic preaching by either the courts or the legislature."  

III. RESTRICTIONS ON THE TRANSFER OF SHARES

A. BACKGROUND

The partnership nature of the close corporation makes it essential that the participants be allowed to restrict shareholdings to associates acceptable to them. Ownership and management generally coincide in a close corporation, with the shareholders not uncommonly devoting full time to the business. These owner-managers typically make business decisions with little regard to the size of their respective holdings. Participants in a close corporation, therefore, are anxious to limit participation to persons with whom they can work in close confidence.

In addition, there are other reasons why stock transfer restrictions are desirable in a close corporation. Participants want to guard against the acquisition of shares by competitors who might subvert the enterprise from within by obtaining access to books and records. Further, close corporations often try to exclude persons who are solely interested in investment possibilities, since their interests often conflict with those of the active owners. For example, active owners would prefer to withdraw corporate earnings in the form of salaries to avoid double taxation. Since these salaries often place the owner-managers in a high tax bracket, they would rather place additional profits in retained earnings than pay them out in dividends.

of his stock purchase. The validity of such a provision as to them should not depend upon their appearance in a specific instrument, otherwise there may be a frustration of the legitimate expectations of the shareholders.

42. The New Jersey, Delaware and Model Act do not limit these provisions to close corporations.
43. Bradley, supra note 11, at 1158.
44. O'Neal, Restrictions on Transfer of Stock in Closely Held Corporations: Planning and Drafting, 64 HARV. L. REV. 773 (1952).
45. Id.
This allows avoidance of personal income tax until stock is sold and taxed at capital gains rates or until death when the appreciation in the value of the stock will escape income taxation in toto.\textsuperscript{46} These practices, however, are obviously not acceptable to the outside investor who depends on dividends for a return on his investment. These conflicts could lead to litigation, which is not only expensive but detrimental to the good will of the business.\textsuperscript{47}

The few states which have allowed statutory transfer restrictions\textsuperscript{48} provide little more than a general authorization for such restrictions. The Texas Business Corporation Act, for example, provides that “any corporation may impose restrictions on the sale or other disposition of its shares . . . which do not unreasonably restrain or prohibit transferability . . . .”\textsuperscript{49} Although these statutes manifest a general legislative approval of transfer restrictions, their lack of detail engenders some uncertainty as to what constitutes a “reasonable” restriction. The Delaware statute alleviates some of this uncertainty by specifying in some detail what transfer restrictions are to be permitted. Its general provision on transfer restrictions—applicable to all corporations, widely held and close—permits restrictions which: (1) give the corporation or its shareholders a right of first refusal with respect to the restricted shares; (2) obligate the corporation or its shareholders to buy the restricted shares when offered by a fellow shareholder; (3) require the corporation or the holders of its securities to approve a proposed transfer of the restricted securities; (4) prohibit the transfer of the restricted securities to designated persons or classes of persons if such designation is not manifestly unreasonable, or (5) “any other lawful restriction on transfer or registration.”\textsuperscript{50} In addition, if a particular transfer restriction on the shares of a close corporation is found unlawful, the corporation is given a 30 day purchase option to acquire the restricted securities, either at a

\textsuperscript{46} INT. REV. CODE of 1954, § 1014(a).
\textsuperscript{47} O'Neal, supra note 44, at 774.
\textsuperscript{48} A. FREY, C. MORRIS & J. CHOPER, CASES AND MATERIALS ON CORPORATIONS 375 (1966).
\textsuperscript{49} TEXAS BUS. CORP. ACT art. 2.22 (1957).
\textsuperscript{50} DEL. CODE ANN. tit. 8, § 342 (b) (1967). DEL. CODE ANN. tit. 8, § 342 (b) (1967) provides that: “The certificate of incorporation of a close corporation may set forth the qualifications of stockholders, either by specifying classes of persons who shall be entitled to be holders of record of the stock of any class, or by specifying classes of persons who shall not be entitled to be holder of stock of any class.”
price agreed upon by the parties or at its appraised value.\textsuperscript{51} Finally, if a transfer of stock is made in violation of any authorized agreement restricting the transferability of a close corporation's shares, the corporation may refuse to register the transferred stock in the name of the transferee.\textsuperscript{52}

B. MINNESOTA LAW

There is no provision in the Minnesota act specifically authorizing restrictions on the transfer of stock.\textsuperscript{53} The only Minnesota provisions that deal with transfer restrictions are two Uniform Commercial Code provisions which provide that "[a] lien upon a security in favor of an issuer thereof is valid against a purchaser only if the right of the issuer to such a lien is noted conspicuously on the security"\textsuperscript{54} and that "unless noted conspicuously on the security a restriction on transfer imposed by the issuer even though otherwise lawful is ineffective except against a person with actual knowledge of it."\textsuperscript{55} Perhaps this legislative neglect is due in part to the Minnesota Supreme Court's indication that it would tolerate a reasonable transfer restriction for which there is a good business reason. In \textit{Model Clothing v. Dickenson},\textsuperscript{56} the court held that a "first refusal" agreement between all stockholders was valid, since it was not an unreasonable restraint on the power of alienation.

C. PROPOSED REFORM

Even though the Minnesota court has demonstrated a tolerance for reasonable transfer restrictions, legislation specifically authorizing such agreements is still needed. The security of sizable investments should not depend on something as unpredictable as judicial tolerance. The reasonableness standard of \textit{Model Clothing} is similar to the statutory rule in Texas since the interpreter is still faced with a question as to what con-

\textsuperscript{51} \textit{Del. Code Ann. tit. 8, § 349 (1967).} \textit{N.J. Rev. Stat. § 14A:7-12(4) (1969)} provides similarly except that its coverage is not limited to the close corporation. Note that the particular advantage of this provision is that it will allow untried and untested restrictions to be used with more freedom by reducing the severity of the penalty in case they are held unreasonable.

\textsuperscript{52} \textit{Del. Code Ann. tit. 8, § 347(d) (1967).}

\textsuperscript{53} For a discussion of restriction on the transfer of stock see F. O'Neal, \textit{Close Corporations} ch. VII (1958).

\textsuperscript{54} \textit{Minn. Stat. § 336.8-103 (1967).}

\textsuperscript{55} \textit{Id. § 336.8-204.}

\textsuperscript{56} 146 Minn. 367, 178 N.W. 957 (1920).
stitutes a "reasonable" restriction. The Minnesota legislature could spell out what type of restrictions are to be permitted by expressly authorizing first options, buy-sell agreements, consent restraints, absolute restraints to designated persons and "any other lawful restriction on transfer." Further, where a transfer restriction is held to be unreasonable, the statute should provide means whereby the corporation can acquire the restricted shares at their appraised value. However, in order to protect the interests of both the existing shareholders and potential transferees, the Minnesota statute should provide that no transfer restriction shall be valid unless it is unanimously adopted by the shareholders, appears in either the certificate of incorporation or the bylaws of the corporation, and is noted conspicuously on the restricted securities.

Finally, the legislature should be cautious in validating share transfer restrictions for publicly held corporations. This type of corporation should have no overriding concern for the identity of prospective shareholders since they rarely become active in the business, and dissatisfied shareholders can easily sell their shares on the market. Therefore, to avoid any undue restraint on alienation of shares in the public issue corporation context, any statutory validation of transfer restrictions should be limited to the close corporation.

58. See note 51 supra.
60. It is clear that in order to effectively limit the advantages of this and other legislation to the close corporation it will be necessary for the legislature to define what is meant by a "close corporation." In so doing the legislature should follow the lead of Delaware (see note 1 supra) and adopt particularized criteria which a corporation must meet. At a minimum such legislation should be made available only to corporations (1) which have less than 30 shareholders, and (2) whose shares are not traded on a national securities exchange or regularly quoted on an over-the-counter market.

Once having so defined and limited the close corporation, the legislature should again follow the lead of Delaware and provide some means for the preservation of close corporation status in the event that status is involuntarily lost. First, the corporation should be given a reasonable grace period in which to take whatever steps within its power are necessary to correct the situation. Second, the courts should be given jurisdiction to issue all orders necessary to restore a corporation's close status by enjoining any act or threatened act either by the corporation or its shareholders which would destroy that status, including the enjoining of any transfer or threatened transfer of stock in contravention of a lawful transfer restriction. See Del. Code Ann. tit. 8, § 348 (1967).
IV. SHAREHOLDER VOTING AGREEMENTS

A. BACKGROUND

It has already been observed that active participation in management by the owners is normal in the close corporation. Since under most statutory schemes management is lodged in a board of directors, it is imperative that each shareholder be represented on the board if he is to share in the control of the enterprise. The conventional statutes, however, require that directors be chosen by the shareholders, acting at a lawful meeting, upon vote of a plurality, under straight or cumulative voting. These provisions may make it difficult for a minority shareholder even under cumulative voting to become elected to the board. In order to circumvent such a difficulty, associates often find it necessary to agree in advance to vote their shares in such a way as to assure each participant representation on the board.

Stockholder voting agreements, however, have not always met with judicial favor, although the modern tendency is to approve them, provided a proper purpose can be found. In order to clarify this trend, most modern close corporation legislation specifically validates shareholder voting agreements. The New Jersey statute, for example, provides that agreements between shareholders directing that their votes shall be cast in a specified manner are valid if in writing and signed. South Carolina has a similar provision with the additional stipulation that the agreements be subject to a ten year time limitation.

62. 1 F. O'Neal, supra note 58, § 5.04, at 227.
65. N.J. REV. STAT. § 14A:5-21 (1) (1969) provides as follows:

66. S.C. CODE ANN. § 12-16.15 (Supp. 1962) provides as follows:

An agreement between two or more shareholders, if in writing and signed by the parties thereto, may provide that in exercising any voting rights, the shares held by them shall be voted as therein provided, or as they may agree, or as determined in accordance with a procedure agreed upon by them.

An agreement between two or more shareholders, if in writing and signed by the parties, may provide that in exercising any voting rights of shares held by the parties, including any vote with respect to directors, such shares shall be voted as provided by the agreement, or as the parties may agree, or as determined in accordance with a procedure agreed upon by the parties. Such agreement shall be valid and enforceable as be-
B. MINNESOTA LAW

Minnesota has no statutory provision nor any case that validates shareholders' voting agreements. However, in view of the Minnesota Supreme Court’s acceptance of shareholder-management agreements, there is no reason to believe that the court would not follow the modern trend and allow shareholders' voting agreements provided a proper purpose can be found.

C. PROPOSED REFORM

Even though the Minnesota court would most likely approve voting agreements, such agreements should be removed from the arena of judicial uncertainty. Minnesota should affirmatively validate voting agreements by adopting a provision similar to that of New Jersey. Such a provision should be free of any time limitation, and there is no overriding policy reason why its applicability should be restricted to the close corporation.

This type of provision may not, however, go far enough in giving a shareholder in a close corporation the protection he needs. The Minnesota legislature should consider some statutory method by which voting agreements can be specifically enforced. Such a provision is necessary because of judicial hesitancy to specifically enforce voting agreements. This is demonstrated by Ringling Brothers-Barnum & Bailey Combined Shows, Incorporated v. Ringling, where the Delaware Supreme Court

\begin{quote}
\textit{tween the parties thereto, for a period not to exceed ten years from the date of its execution. Such agreement may be extended or renewed. . . .}
\end{quote}

67. See part IID infra.
68. See note 65 supra.
69. It can be argued that such a provision should limit the duration of such contracts in order to preclude the possibility that a voting agreement of long-term or indefinite duration may become oppressive to one or more of the parties. Often, however, if an owner-manager of a close corporation is to realize his expectations in the enterprise he must be assured of a share of the control on a long-term basis. If the parties wish to preclude the possibility of later oppression, they can easily insert a time limitation in their agreement.
70. Neither the New Jersey nor the South Carolina statutes authorizing shareholders' voting agreements (see notes 57 & 59 supra) are limited in applicability to the close corporation. Whether a shareholder exercises his voting rights independently or in conjunction with others according to agreement should be a matter of individual discretion rather than a matter of legislative predetermination in the publicly held as well as in the close corporation context.
71. 29 Del. Ch. 610, 53 A.2d 441 (Sup. Ct. 1947).
held a voting agreement valid, but refused specific enforcement of the agreement. The court's remedy was confined to refusing to count the votes of the recalcitrant party, with the result that the purpose for which the agreement was entered was defeated, even though the agreement itself was held valid.

No state has yet attempted to preclude this type of result by enacting a statutory provision providing for mandatory specific enforcement of voting agreements. One commentator suggests that a legislature could so provide by directing courts to issue mandatory injunctions prior to an election, directing the shares to be cast as agreed. The court could also be directed to review the outcome of a contested election and to consider all shares to have been voted as agreed under any valid voting agreement. The nonconforming voter would be allowed the defense of petitioner's own contractual breach or his breach of any fiduciary duty to the defendant.

V. SHAREHOLDER-MANAGEMENT AGREEMENTS

A. BACKGROUND

It is well settled that the board of directors of a publicly held corporation should be free to exercise its judgment independent of interference from shareholders. Such a requirement, however, is unrealistic, impractical and, in respect to minority interests, oppressive, when applied to the close corporation. Since the shareholder commonly invests all his time and fortune in the corporation, management decisions are often directly related to the individual shareholder's economic security. This leads to a higher probability of intershareholder dissension resulting in an oppression of minority interests by the majority.

In order to avoid this state of affairs, the owner-managers frequently attempt to preclude future conflict by binding themselves through shareholders' agreements to certain future conduct which can be specifically enforced.

In general, however, courts have been hostile to shareholder-management agreements and uniformly strike them down whenever they are found to transgress statutes requiring

---

72. Md. Ann. Code art. 23, § 104 (Supp. 1957), provides that shareholders' agreements may in the discretion of the court "be enforced by injunction or by such other relief as the court may determine to be fair and appropriate in the circumstances."
73. Bradley, supra note 63, at 1163.
74. Note, supra note 59, at 719.
75. Id.
that a board of directors manage the corporation.\textsuperscript{76} Unfortunately, this approach precludes the use of the device, since the agreements most useful to the close corporation will always restrict the freedom of the board. For example, shareholders' agreements dealing with removal of officers, dividend distribution, employment contracts, arbitration and dissolution would likely be struck down on this basis.\textsuperscript{77}

There is no good reason to continue to prohibit these types of agreements for the close corporation. The requirement that the board of directors manage the company independently was designed to assure responsible management to investors in a publicly held company. Such assurance is not necessary in a close corporation where ownership and management coincide. Further, such agreements do not injure either creditors or the public. In fact, they may even benefit creditors and the public by insuring that the operation of the company will continue smoothly without debilitating internal conflict.\textsuperscript{78} Finally, our systems of economics and jurisprudence are designed to provide individuals with the freedom to arrange their economic affairs through contracts which are not against public policy.\textsuperscript{79}

In recognition of these facts, many state legislatures have amended corporation statutes to permit shareholders' agreements which restrict the independence of the board of directors. The New York statute, for example, specifically validates such agreements if they appear in the certificate of incorporation and have the approval of the holders of all outstanding shares.\textsuperscript{80} Florida's statute is similar, but it also provides detailed guidance as to what type of shareholders' agreements are lawful by specifically allowing those which relate to: (1) the management of the business of the corporation; (2) the declaration and payment of dividends or division of profits; (3) the election of officers and directors, and (4) restrictions on transfers of stock.\textsuperscript{81}

\textsuperscript{76} The two leading cases on this point are McQuade v. Stoneham, 263 N.Y. 323, 189 N.E. 234 (1934), and Clark v. Dodge, 269 N.Y. 410, 199 N.E. 641 (1936).

\textsuperscript{77} Note, supra note 59, at 719.

\textsuperscript{78} Id. at 720.

\textsuperscript{79} Id. at 713.

\textsuperscript{80} N.Y. Bus. Corp. Law § 620 (b) (McKinney Supp. 1966).

B. MINNESOTA LAW

The Minnesota Business Corporation Act unequivocally states that "the business of a corporation shall be managed by a board of directors."\(^8^2\) The Minnesota Supreme Court, on the other hand, has shown itself to be receptive to shareholder management agreements. In \textit{Hart v. Bell},\(^8^3\) a defendant shareholder was induced to lend large sums of money to his floundering corporation. An agreement among all shareholders provided that no dividends were to be declared until all loans were repaid to defendant. The court upheld the agreement, stating:

The practical conduct of a modern business corporation compels a frank recognition that "an agreement by a number of stockholders to combine their votes in order to effectuate a particular policy is not of itself unlawful in the absence of evidence of an intent to defraud the other stockholders or to secure a private benefit at the expense of the corporation or the other stockholders."\(^8^4\)

C. PROPOSED REFORM

Despite the rather far-reaching language of \textit{Hart}, legislation is needed to insure the validity of shareholder-management agreements. The agreement should be valid whether embodied in the articles of incorporation, the bylaws, or even in a side agreement.\(^8^5\) While some statutes require that the agreement be embodied in the articles of incorporation,\(^8^6\) the reason for such a restriction is not clear, although the drafters could have been concerned with notice to those dealing with the corporation. If so, the requirement is not warranted. First, it is questionable whether third parties examine the articles in this context, or, for that matter, should be bound by them. In addition, an inadvertent failure to include the agreement in the articles might allow a party to renege on his contractual obligations.\(^8^7\) Further, a provision requiring embodiment in the certificate of incorporation would have the effect of invalidating any agreement entered into before the enactment of the statute if any party was unwilling to incorporate the agreement into the certificate.\(^8^8\)

There should also be an unequivocal requirement that any

\(^{82}\) MINN. STAT. § 301.28 (1967).
\(^{83}\) 222 Minn. 69, 23 N.W.2d 375 (1946).
\(^{84}\) Id. at 78, 23 N.W.2d at 380.
\(^{85}\) See FLA. STAT. ANN. § 608.0105 (1963).
\(^{87}\) Meyers, supra note 64, at 588.
\(^{88}\) Bradley, supra note 63, at 1183.
shareholder-management agreement have unanimous shareholder consent. This is necessary because of the inherent possibility that such agreements will be used by majority interests to suppress minority interests not parties to the agreement. In addition, in order to insure that liability for managerial acts will continue to be commensurate with responsibility, any statute validating shareholders' agreements relating to management should contain a provision imposing liability upon shareholders for managerial acts and omissions to the extent that the discretion or powers of the directors are controlled by the agreement.89 Finally, in order to insure responsible management to widespread investors in a publicly held company, the application of such a statutory provision should be limited to the close corporation.90

A question which can always arise under statutory provisions validating these shareholders' agreements is whether such provisions can be read to allow the elimination of the board of directors altogether. There is no overriding policy reason why the owner-managers of a close corporation should be encumbered by a statutory board of directors requirement. Thus, a revision of the Minnesota act should avoid any possible ambiguity by adopting a provision allowing a close corporation to be managed directly by the stockholders in place of a board of directors.91

VI. DISSOLUTION

A. BACKGROUND

Due to dissension, voting distribution, higher voting re-

89. Id. Meyers, supra note 64, at 588-89. N.J. REV. STAT. § 14A: 5-21 (1969), for example, provides as follows:
The effect of any such agreement shall be to relieve the directors and impose upon the shareholders the liability for managerial acts or omissions that is imposed on directors by law to the extent that, and so long as, the discretion or powers of the directors in their management of the corporate affairs is controlled by any such provision.
90. See note 72 supra.
91. Del. Code Ann. tit. 8, § 351 (1987), for example, provides as follows:
The certificate of incorporation of a close corporation may provide that the business of the corporation shall be managed by the stockholders of the corporation rather than by a board of directors. So long as this provision continues in effect,
(1) No meeting of the stockholders need to be called to elect directors;
(2) Unless the context clearly requires otherwise, the stockholders of the corporation shall be deemed to be directors;
(3) The stockholders of the corporation shall be subject to all liabilities of the directors.
quirements and many other factors inherent in any closely held enterprise, seriously disabling deadlocks frequently occur among the shareholders and directors of a closely held corporation. When this state of affairs develops, a dissatisfied shareholder may find himself in an almost impossible situation. Unlike a partner, he cannot simply terminate the enterprise and get out. At the same time, unlike a shareholder of a publicly held company, he cannot simply sell his shares, since the shares of a close corporation rarely have a ready market. To make matters worse, the shares of a close corporation are, as previously noted, often subject to transfer restrictions, which may enable an obstinate associate to prevent any sale of the shares whatever.

Frequently, the result is that the only remedy available to a dissatisfied shareholder is to attempt a dissolution of the corporation.

Under most general corporation statutes, however, even this remedy may be unavailable. In order to rectify this situation several states have adopted statutes designed to give close corporation shareholders easier access to dissolution. New Jersey and Delaware, for example, allow incorporators to provide in the certificate of incorporation that any dissatisfied shareholder may effect a dissolution of the corporation at will or upon the occurrence of specified events.

B. Minnesota Law

The Minnesota act provides for either voluntary or involuntary dissolution. Voluntary dissolution may be instituted

---

82. 2 F. O'Neal, supra note 53, § 9.02, at 166-167.
83. Uniform Partnership Act § 31 (1914).
84. 2 F. O'Neal, supra note 53, § 9.02, at 167.
85. See text accompanying notes 99-106 infra.
86. N.J. Rev. Stat. § 14A:12-5(1) (1969) provides as follows:
   The certificate of incorporation may provide that any shareholder, or any specified number of shareholders, or the holders of any specified number or proportion of any class or series, may effect the dissolution of the corporation at will or upon the occurrence of a specified event.
87. Del. Code Ann. tit. 8, § 355(a) (1987) provides as follows:
   The certificate of incorporation of any close corporation may include a provision granting to any stockholder, or the holders of any specified number or percentage of shares of any class of stock, an option to have the corporation dissolved at will or upon the occurrence of any specified event or contingency.
upon the approval of at least two-thirds of the voting power of
the shareholders. It is obvious that this provision will not
aid the dissatisfied shareholder of a close corporation since a
corporation which is already deadlocked because of high voting
requirements will presumably not be able to muster the two-
thirds majority required for dissolution. Shareholders often
try to resolve this problem in advance through various types of
agreements, the most common of which is that each shareholder
will vote for dissolution if a deadlock continues for a stated
period of time. In order for such an agreement to be en-
forceable, however, there would have to be some general stat-
utory validation of shareholders' agreements which impinge on
the power of the board of directors. Minnesota as noted previ-
ously, has no such validation.

Under the Minnesota act a dissatisfied shareholder may
petition for involuntary dissolution of the corporation on the
ground “that there is internal dissension and that two or more
factions of the shareholders in the corporation are so deadlocked
that its business cannot longer be conducted with advantage to
its shareholders . . . .” This provision, however, does not
provide adequate relief since the Minnesota court has limited
its effect by permitting dissolution only when the dissension or
deadlock renders the corporation insolvent or unprofitable, ap-
parently under the assumption that dissolution of a prosperous
corporation will injure not only the majority stockholders, but
the public as well. This view may be justified when applied
to a public corporation where a dissatisfied shareholder can
easily redeem his investment by selling his shares, but it is clearly
oppressive when applied to a close corporation where a share-
holder can protect his investment only through effecting a dis-
solution. A part owner of an incorporated partnership should,
to the same extent as an ordinary partner, be allowed to dis-
solve the company whether it is prosperous or not.

100. Note, supra note 59, at 735.
101. Israels, The Sacred Cow of Corporate Existence: Problems of
Deadlock and Dissolution, 19 U. Chi. L. Rev. 778 (1952).
102. See part II B supra.
103. Minn. Stat. § 301.50 (1) (1967).
104. Id. § 301.49 (4).
105. See, e.g., In re Hedberg-Freučżeun & Co., 233 Minn. 534, 47
N.W.2d 424 (1951); Note, supra note 59, at 735.
106. Note, supra note 59, at 735.
C. PROPOSED REFORM

The Minnesota legislature should follow the examples of Delaware and New Jersey and allow dissenting shareholders of a close corporation the power to effect dissolution at will. Any such provision, however, should be limited to the close corporation. A remedy as drastic as dissolution should obviously not be given to a minority shareholder of a publicly held company\textsuperscript{107} because of the great potential injustice to other investors and because he can easily sell his shares on the open market. In addition, there is a great public interest in the continuation of such businesses. This public interest, however, should yield to the dissident minority shareholder in a close corporation whose only choice is to sell out cheaply or retain an investment upon which he may garner no return.\textsuperscript{108}

In addition to providing an individual shareholder of a close corporation with access to dissolution, the Minnesota legislature should consider instituting other statutory methods of resolving deadlocks, short of dissolution. In those cases where for some reason dissolution is not a satisfactory remedy (where, for example, it would result in loss of value or in expensive and time consuming litigation), the Minnesota act should provide that the shareholder, rather than dissolving the corporation, may petition a court either to appoint a custodian to temporarily take control of the company,\textsuperscript{109} or alternatively, to have a provisional director appointed to break a deadlock on the board of directors.\textsuperscript{110}

VII. CONCLUSION

It is apparent that the Minnesota close corporation has special needs which can only be fulfilled by revision of the Minnesota Business Corporation Act. Such legislation should be based on the recognition that the close corporation is a legitimate business enterprise. It should be found on the premise that there is no sacred, logical or necessary connection between limited liability and the operation of a corporate enterprise in a certain way. The price the participants in a close corporation have to pay for limited liability should not include the necessity of running their enterprise according to an inflexible, traditional, corporate blue-

\textsuperscript{107} Symposium, 52 Nw. U.L. Rev. 345, 412 (1957).
\textsuperscript{108} Note, supra note 59, at 716.
\textsuperscript{110} Id. § 353.
print. Contemporary business practice should be a crucial factor in the development of corporate law, and public corporations and close corporations can no longer realistically be made to conform to a single operating procedure. As long as the deviations from the traditional corporate pattern are limited to internal control and management, are accepted by all the shareholders, and cause no injury to outsiders, a close corporation should be allowed to operate as flexibly as its needs demand.