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A Comparison of the Close Corporation Statutes of Delaware, Florida and New York

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COMMENTS

A COMPARISON OF THE CLOSE CORPORATION STATUTES OF DELAWARE, FLORIDA AND NEW YORK

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I. INTRODUCTION

Few states have enacted close corporation statutes, and those enacted have been less than successful. The Florida Close Corporation Act has been called "an experiment that failed."[1] The New York statutes applicable to close corporations are interspersed among the general corporate acts.[2] Last year, Delaware ventured into the arena of experimentation by enacting a subchapter to her general corporation laws, *viz.*, "Subchapter XIV. Close Corporations; Special Provisions." The purpose of this paper is to compare the legislation of these three states. Since Delaware's Subchapter XIV is the most recent, and in the writer's opinion the most complete, it will serve as the basis from which comparisons will be made and evaluations as to the business effect of the statutes will be made. It is the writers' opinion too that the legislation in these states will undergo change and that more legislation, which pre-

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1. Dickson, *The Florida Close Corporation Act: An Experiment that Failed*, 21 U. MIAMI L. REV. 842 (1967).

2. *See generally* N.Y. BUS. CORP. LAW (1965).

sumably will be patterned after the successful aspects of the existing enactments, is yet to be passed in the overwhelming majority of states.[3]

II. CLOSE CORPORATION DESIGNATION

A. *Definitional Aspects*

1. IN GENERAL

Before proceeding specifically to the statutory definitions, it should be pointed out that scholars have given a wide definitional range to "close corporations." Professor Israels distinguishes a close corporation from a public one on the basis of the former's having an identity between management and ownership.[4] Another scholar considers the number of stockholders to be the most important criterion.[5] O'Neal, in his two-volume work on close corporations, uses "[t]he term 'close corporation' [to mean] a corporation whose shares are not generally traded in the securities market."[6] B. J. Tennery, Dean and Professor of Law at the American University, noted the seeming different definitions and pointed out that they "demonstrate on closer examination that a common understanding of the term does exist, if not a common definition."[7] He then goes on to define, in what the writers have found to be its clearest expression, a close corporation as:

> a business organization in normal corporate form with shares not generally traded in security markets and few shareholders, all of whom are generally known to one another, who wish to somehow participate in the management of affairs in a partnership sense, but who have limited liability.[8]

It should be pointed out that the terms "close corporation," "closed corporation," and "closely-held corporation" are often used synonymously.[9] However, O'Neal indicates that, technically, "closed" may indicate an intention to prevent outsiders from acquiring an interest in the corporation; whereas "closely-held" emphasizes the limited number of shareholders.[10] In any case, a discussion of these differences is beyond the scope of this paper.

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3. Besides New York, Florida and Delaware, only Maryland, North Carolina, and South Carolina have passed close corporation legislation.

4. Israels, *The Close Corporation and the Law*, 33 CORNELL L.Q. 488 (1948).

5. H. HENN, HANDBOOK OF THE LAW OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES 401 (1961).

6. 1 F. O'NEAL, CLOSE CORPORATIONS, § 1.02 (1958).

7. Tennery, *The Potential of the Close Corporation: A Question of Economic Validity*, 14 HOWARD L.J. 241, 247 (1968).

8. *Id.*

9. *Id.* at 249 and authority cited therein.

10. F. O'NEAL, *supra* note 6, § 1.05.

2. BY STATUTE

For a corporation to have close corporation status in Delaware, it must comply with three requirements in addition to those otherwise required of corporations under the state law. The certificate of incorporation must provide that:

> (1) All of the corporation's issued stock of all classes, exclusive of treasury shares, shall be held of record by not more than a specified number of persons, not exceeding thirty; and
> (2) All of the issued stock of all classes shall be subject to one or more of the restrictions on transfer permitted by section 202 of this title, and
> (3) The corporation shall make no offering of any of its stock of any class which would constitute a "public offering" within the meaning of the United States Securities Act of 1933, as it may be amended from time to time.[11]

The Florida act simply states, as O'Neal does,[12] that a "close corporation means a corporation for profit whose shares of stock are not generally traded in the markets maintained by securities dealers or brokers."[13] Where the New York statutes grant, in effect, a close corporation privilege, it is limited to (and therefore a close corporation could be said to be defined as) a "corporation . . . 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 affiliated securities association."[14]

It has been pointed out that corporations whose use of the special privileges that accompany close corporation status would be unjustified should be precluded from achieving that status.[15] A logical means of comparison and evaluation of the definitional aspects of the statutes, then, is to consider in what way the definitional requirements prevent the unjustified achieving of close corporation status.

The following have been suggested as limitations on the availabilty of close-corporation privileges: (1) a limited number of stockholders, (2) stockholder representation in management agreements, (3) a nonpublic offering requirement.[16] As to the first limitation, since close corpo-

11. DEL. CODE ANN. ch. 1, § 342 (1967). [Hereinafter Delaware provisions will be cited as DEL. § —.]

12. *Supra* note 6 and accompanying text.

13. FLA. STAT. § 608.0100(2) (1967). [Hereinafter Florida provisions will be cited as FLA. § —.]

14. N.Y. BUS. CORP. LAW § 620(c) (1965). [Hereinafter New York provisions will be cited as N.Y. § —.]

15. Comment, *Delaware's Close-Corporation Statute*, 63 NW. U.L. REV. 230, 235 (1968).

16. *Id.* at 235-36.

rations can be managed by stockholders,[17] the status should not be available to those corporations whose stockholders are so numerous that the corporation cannot effectively operate either without a board or with one restricted in accordance with other statutory privileges. Delaware's limiting the number of shareholders to thirty provides such a limitation.[18] The failure of Florida and New York to limit the number of shareholders seems to make the status available to corporations having a large number of shareholders. However, one writer has pointed out that if the stockholders become very numerous, trading in over-the-counter markets would inevitably result.[19] When such over-the-counter trading begins to be regular, it would seem that the corporation would no longer be qualified under the close corporation provisions; at least it so appears under the New York provision which grants, in effect, a close corporation management privilege "*so long as* the shares of the corporation are not listed . . . or regularly quoted . . . ."[20] The Florida act is not so explicit, but the language "close corporation means [one] whose shares of stock are not generally traded . . ."[21] might imply that the corporation would lose its status once its shares became generally traded.

The second and third suggested limitations on the close corporation privileges, *i.e.*, stockholder representation in management agreements and a non-public offering requirement, exist under the Delaware statute,[22] but are not part of the definitional requirements of the Florida or New York legislation. The stockholder representation requirement in Delaware is sought to be achieved by requiring that each share in the close corporation be subject to one or more of the transfer restrictions permitted by another statutory provision.[23] Though the transfer restrictions would certainly enable a corporation to preserve its closeness by preventing the taking in of powerless investors, they would not require it to do so. The statute has been criticized on this ground,[24] and it has been pointed out that the minimum of one transfer restriction requirement could be satisfied simply by adopting a restriction prohibiting transfers to competitors.[25]

Finally, under Delaware's definition of a close corporation, there is a prohibition against public offerings[26] as defined in the "United States Securities Act of 1933, as it may be amended from time to time." Though

17. *See* discussion at 526 *infra*.

18. DEL. § 342(a)(1).

19. Latty, *The Close Corporation and the New North Carolina Business Corporation Act*, 34 N.C.L. REV. 432, 439 (1956).

20. N.Y. § 620(c) (emphasis added).

21. FLA. § 608.0100(2). The problems arising from the ambiguity of this language are discussed by Dickson, *supra* note 1, at 843-44.

22. DEL. §§ 342(2) and 342 (3).

23. *See* DEL. § 202.

24. Comment, *Delaware's Close-Corporation Statute*, *supra* note 15, at 243-44.

25. *Id.* at 244.

26. DEL. § 342(3).

a discussion of the non-public offering exemption of the Securities Act[27] is beyond the scope of this paper, it should at least be mentioned that every corporation issuing stock must comply with it through registration or by coming within one of its exemptions.

The Delaware act forces the close corporation to choose the private offering exemption. It is the writers' opinion that the better approach is to leave open to the corporation the options of registration or the intrastate offering exemption, especially since in the latter choice "friends, neighbors, and associates"[28] can be shareholders (whereas they would not necessarily be "sophisticated" under the private offering exemption).[29] "Closeness" does not, after all, require that all investors be sophisticated; in fact, it would appear that under the O'Neal definition[30] "friends, neighbors, and associates" are definitely contemplated.

B. *Formation of a Close Corporation*

Delaware specifically requires a close corporation to provide in its certificate a heading which contains the name of the corporation and which states that it is a close corporation.[31] The Florida act, though providing for election by existing corporations, is silent as to those formed subsequently to the passage of the act.[32] Writers have interpreted the act differently, finding presumptions in opposite directions.[33] In addition, it is not clear whether a corporation may reject part of the act and accept other parts of it. The act is said to be "permissive and not mandatory,"[34] so it would appear that certain provisions could be rejected and others accepted. However, as one of the sections has a specific provision for rejection, it has been argued that this implies that other sections cannot be rejected.[35]

New York has no specific provision for the formation of a close corporation.

C. *Election to Become a Close Corporation*

Under the Delaware act,[36] a two-thirds vote of the shares of each class of stock outstanding is necessary to approve an amendment certificate, which must be executed, acknowledged, filed, and recorded in

27. 15 U.S.C. § 77(d)(2) (1964), formerly 48 Stat. 77 (1933).

28. SEC Securities Act Release No. 4552 (Nov. 6, 1962), 1 CCH FED. SEC. L. REP. ¶ 2774.

29. *See, e.g.*, SEC v. Ralston Purina Co., 346 U.S. 119 (1953).

30. *See* text accompanying note 8 *supra*.

31. DEL. § 343.

32. FLA. § 608.0100(1).

33. Dickson, *supra* note 1; *contra*, Note, *Statutory Recognition of the Close Corporation In Florida*, 16 U. FLA. L. REV. 569, 573 (1964).

34. FLA. § 608.0100(1).

35. Note, *Statutory Recognition Of The Close Corporation In Florida*, 16 U. FLA. L. REV. 569, 574-75 (1964).

36. DEL. § 344.

accordance with a stipulated procedure in order for an existing corporation to become a close corporation by election. The Florida act simply requires "written consent of the owners of a majority of the voting stock."[37] There is no provision as to where the written consent is to be filed, and it also appears that such an election can occur without the consent or even the knowledge of the board of directors. In New York the statutory provision allowing an otherwise illegal restriction on the discretion or powers of the board of directors (*i.e.*, allowing a close corporation privilege) requires (1) the approval of all the incorporators or holders of record of outstanding shares and the insertion of the restrictive agreement into the articles of incorporation either originally or subsequently by amendment thereof, and (2) if, subsequently to the adoption of the agreement, shares are transferred or issued, that they be transferred or issued only to persons with knowledge or notice of the agreement, or who consented in writing to it, and (3) the noting of the existence of such an agreement on the face or back of every stock certificate.[38]

III. TERMINATION

A. *Voluntary Termination*

Under the Delaware act[39] a corporation, by an amendment approved by a vote of the holders of record of at least two-thirds of the outstanding shares of each class of stock, may voluntarily terminate its close corporation status. The two-thirds requirement is, however, a minimum, and under the act[40] may be increased to unanimity for any or all classes by a provision to such effect in the certificate of incorporation. Such a provision cannot be amended, repealed or modified by any vote less than that required to terminate the close corporation status. These provisions clearly give the investors an early opportunity to bargain for protection so that later the close corporation status will not be terminated against their will.

The Florida act is silent as to voluntary termination of the close corporation status. Keeping in mind that the act states that the provisions are permissive rather than mandatory, it would appear that the method of termination will be determined, in each case, by the method in which the specific provision was utilized in the first place. For example, if corporate management by the stockholders had been provided for in the articles of incorporation, as permitted by section 608.0102 of the act, amendment of the articles (through the amendment process of the general corporation provisions[41]) would be the means by which such

37. FLA. § 608.0100(1).
38. N.Y. § 620(b).
39. DEL. § 346(a).
40. DEL. § 346(b).

a close corporation privilege would be terminated. Such a procedure is not clearly the correct one, however, because it requires approval by the board of directors, and, as under the above example, there may not always be such a board. However (as common sense dictates), approval by the holders of a majority[42] of the shares entitled to vote might be sufficient. If it is not, voluntary dissolution of the corporation[43] (rather than termination only of the close corporation status) would appear to be the only alternative.

In the case where a close corporation privilege is acquired by the stockholders' entering into a written side agreement,[44] for example, to require the affairs to be conducted in a specific way, the method of termination might be simply the entering into of a subsequent side agreement allowing the board of directors, if any, to use its discretion as to the conducting of the affairs.

Under the New York statute providing for the managerial restriction privilege described above, even though unanimous approval of holders of non-voting shares is required for the invoking of the privilege, a two-thirds vote of voting shares is sufficient to pass an amendment striking the provision unless a higher vote is required by the articles of incorporation.[45] In addition, if the privilege ceases to be available by operation of law,[46] the board of directors may approve a certificate of amendment striking the provision from the articles.[47]

B. *Involuntary Termination*

1. BY OPERATION OF LAW

The most comprehensive and the clearest expression of law in this area—both as to when the termination will occur and as to what, if anything, the corporation can do to prevent the termination—has been achieved by Delaware. The closed corporation status will be lost when any of the definitional requirements qualifying a corporation as a close corporation, or any optional condition permitted to be imposed, has been breached and neither the corporation nor any of the stockholders takes the steps required to remedy the breach.[48] The definitional requirements, it will be recalled, are threefold: (1) stockholder number (maximum of thirty), (2) transfer restrictions, and (3) non-public offering.[49] The optional condition that could be imposed is that which allows the certificate of incorporation to set forth the qualifications of

41. FLA. § 608.18.
42. As required by FLA. § 608.18.
43. Under FLA. § 608.27.
44. Under FLA. § 608.0105.
45. N.Y. § 620(d); *see* text accompanying note 38 *supra*.
46. Under N.Y. § 620.
47. N.Y. § 620(e).
48. DEL. § 345(b).
49. DEL. § 342(a).

stockholders either by designating classes or individuals who shall be entitled to become stockholders of record, or by designating those who shall not be so entitled.[50]

Mention should be made of the two remedial measures that the close corporation can take when a breach of the above occurs, in order to prevent a termination of the close corporation status by operation of law. Both remedies require the filing with the Secretary of State, within thirty days after the occurrence of the breach or within thirty days after the discovery of the breach, of a certificate, duly executed and acknowledged, stating that a certain provision or condition included in its certificate of incorporation has ceased to be applicable. A copy of the certificate must also be sent to each stockholder.[51] After this requirement has been satisfied, the remedies consist of (1) a refusal to register the wrongful transfer,[52] or (2) a court of chancery proceeding to enjoin or set aside the act which would lead to the loss of the close corporation status.[53]

As for the refusal-to-register remedy, the act does not expressly describe the effect of such a refusal. By the definitional requirement of stockholder number and by the optional stockholder qualification condition, it is clear that the holders must be *of record*;[54] therefore, the refusal to register will be sufficient to prevent the loss of close corporation status by operation of law. It is questionable, however, whether a refusal will be effective to remedy the situation created by a transfer in violation of a transfer restriction; if a court would construe "transfer" to include registration, only then would the refusal to register prevent the transfer from violating the restriction, as it would not be complete.[55] If the refusal remedy is not available, the corporation or stockholder would have to resort to a suit in the court of chancery.

It is obvious that the refusal-to-register remedy would be ineffective against the non-public offering restriction, as a mere offer is sufficient to violate the 1933 Securities Act. A suit in the court of chancery to enjoin the proposed offering would thus seem to be the only available remedy.

One writer has pointed out a possible frustration of the refusal-to-register remedy.[56] A certificate provision requiring a greater-than-majority or a unanimous vote for corporate action possibly would prevent use of the refusal-to-register remedy, because such a remedy can only

50. DEL. § 342(b).

51. DEL. § 348(a)(1).

52. Such a refusal is lawful under DEL. § 347(d), when the transferee has or is conclusively presumed, under § 347, to have notice that he is not eligible to be a stockholder, or that a transfer to him would cause the permitted number of stockholders to be exceeded, or that a transfer to him would violate a transfer restriction.

53. DEL. § 348(b); *see also* § 349.

54. *See* DEL. §§ 342(a)(1) and (b).

55. No court has yet so construed the word.

56. Comment, *Delaware's Close-Corporation Statute*, *supra* note 15, at 249.

be effected by corporate action.[57] Furthermore, although registration is normally a ministerial function, registration under the circumstances of a possible status change would seem to require director or stockholder action. If this frustration does exist, however, the chancery action would still be available.

Under the Florida act, in which the definitional requirement is simply that the corporation's stock not be "generally traded,"[58] termination by operation of law would seem to be possible only when a close corporation's shares came to be "generally traded." The act does not so specify, however, and it might even be argued (though in the writers' opinion with little success) that the prohibition against being generally traded is only one of initial qualification. Once under the act the status will not be lost by subsequent general trading of the stock. It should also be pointed out that definitional problems will probably arise as to what constitutes general trading.

It is much clearer in New York than it is in Florida that termination by operation of law exists. Under the New York act, a close corporation privilege exists only "*so long as* the shares of the corporation are not listed . . . or regularly quoted . . . ."[59]

2. THROUGH DISSOLUTION

Discussion of a stockholders' option to dissolve a close corporation under certain circumstances which may be provided in the certificate is deferred until the explanation of conflict privileges.

IV. CONTROL PRIVILEGES

In comparing the close corporation statutes of New York, Florida, and Delaware, one may ask why the latter two states collected these provisions into a separate subchapter. The answer is, of course, to give special consideration to the privileges granted to close corporations, specifically to the control and conflict privileges.[60] This appears to be a functional approach for comparing the managerial and operational aspects of the three states' close corporation statutes.

Control privileges permit a close corporation to modify or abrogate the statutory requirement that a corporation be managed by an independent board of directors. Each of the three states' statutes permit the close corporation to be managed according to stockholders' agreements which restrict the power or discretion of the board of directors.[61] The Florida and Delaware statutes also permit the close corporation to

57. DEL. § 347(d).
58. FLA. § 608.0100(2).
59. N.Y. § 620(c) (emphasis added).
60. Comment, *Delaware's Close-Corporation Statute, supra* note 15.
61. FLA. § 608.0105(1), (3); N.Y. § 620(b); DEL. § 350.

establish a partnership-like control;[62] alternatively, the corporation may operate entirely without a board of directors.[63]

A. *Stockholders' Agreements*

Control devices are well suited to the needs of stockholders of closely held corporations. However, a statute that contains provisions which protect arrangements for preserving control of these corporations is necessary to prevent the arrangements from being declared invalid. Probably the best known case that created this necessity is *Abercrombie v. Davies*.[64] There, the board of directors was sterilized through the use of management agreements. In the course of its opinion, and referring to a Delaware statute,[65] the court said, "This means that our corporation law does not permit actions or agreements by stockholders which would take all the power from the board to handle matters of substantial management policy." This is true especially when unanimous stockholder action is absent.

Delaware, New York, and Florida have now abrogated the rule that directors must direct when applied to close corporations.[66] The New York statute allows charter provisions which would be "otherwise prohibited by law as improperly restrictive of the discretion or powers of the board in its management of corporate affairs."[67] The Florida statute specifically validates stockholders' agreements related to corporate management, division of profits, restrictions on transfer of shares, and arbitration of any issues on which either the management or stockholders are deadlocked.[68]

The statute, however, is not limited to the enumerated subjects. The provisions of both the Delaware and Florida statutes specifically state that stockholders' agreements are not invalid for the reason that they interfere with the discretion of the board of directors, but when they so relieve the directors of such discretion, the liability for managerial acts is imposed upon the parties to the agreement.[69] The Delaware provisions require that the agreement be in writing and the parties thereto hold a majority of the outstanding stock entitled to vote, whereas Florida's provisions require neither a writing nor a majority of the holders but provides that parties may be "less than all the stockholders."[70] Under Florida and Delaware law, these agreements limiting the discretion of the directors may be made with non-stockholders.[71]

62. FLA. § 608.0105(2); DEL. § 354.
63. FLA. § 608.0102; DEL. § 351.
64. 35 Del. Ch. 599, 123 A.2d 893 (1956).
65. DEL. § 141(a).
66. *See* note 21 *supra*.
67. N.Y. § 620(b).
68. FLA. § 608.0105(1).
69. FLA. § 608.0105(3); DEL. § 350.
70. *Id.*
71. *Id.*

This provision is to some extent in conflict with the policy behind the requirement that the stock of the close corporation be subject to restrictions on transfer.[72]

As a result of the power of the majority to make agreements limiting the discretion of the board of directors, the minority stockholder may find that the power to manage the corporation not only is no longer in the hands of the original stockholders, but also that it is held by a party who as a creditor has interests contrary to those of the minority stockholder. Some protection is afforded to minority stockholders in that these agreements are binding only on the parties to the agreement.

The advantage of permitting agreements with non-stockholders which limit the discretion of the directors is that it gives flexibility to close corporations in their dealings with creditors and non-stockholding managers. This flexibility is especially desirable in close corporations which often have limited access to risk capital and expert management and cannot demand either on the corporation's own terms.

B. *Stockholder Management*

In Florida and Delaware, the certificate of incorporation may provide that the business of a close corporation shall be managed by the stockholders rather than the board of directors.[73] The New York statutes, which require only a single incorporator[74] and a board of directors no larger in number than the number of shareholders,[75] provide a functional approach to a one-man close corporation. However, the one-man corporation is the only stockholder-management means available in New York to avoid the necessity of having more than one director.

In an apparent attempt to protect minority shareholders, Florida and Delaware require that the option to permit shareholders to manage the business of a close corporation be embodied in the certificate.[76] Delaware provides that such a provision may be inserted by amendment to the certificate only if there is a unanimous vote of all of the stockholders, and that the provision may be amended out of the certificate by only a majority vote.[77] These requirements seem to be substantial safeguards.

The Florida statute permits a close corporation to conduct business without a meeting by the stockholders if consent in writing to the action is signed by all the persons who would be entitled to vote on the action, and such writing is made part of the corporate records.[78] Florida has a similar provision when the close corporation is run by a board of

72. DEL. § 342(a)(2) makes the restrictions mandatory; FLA. § 608.0105(1)(d) makes the restrictions permissive.

73. FLA. § 608.0102; DEL. § 351.

74. N.Y. § 401.

75. N.Y. § 702(a).

76. *See* note 33 *supra*.

77. DEL. § 351.

78. FLA. § 608.0104.

directors. However, the directors may ratify an action by the signed consent of all directors or members of the appropriate committee.[79]

C. *Partnership-like Control*

Delaware and Florida have enacted provisions that specifically permit a close corporation to create management control agreements to treat the corporation as a partnership, or to arrange relations among the stockholders in a manner generally appropriate only among partners.[80] By provisions previously discussed, a New York close corporation could make the same arrangements; however, without the express provision allowing partnership-like close corporations, the New York agreements would be more susceptible to judicial construction. There is a general judicial tendency to treat "incorporated partnerships" as partnerships for fear that creditors will not have adequate notice of their limited liability.[81] As long as creditors are put on notice of the limited liability, there is no need to require the maintenance of corporate form as the price to pay for limited liability.

The partnership relationship is marked by the freedom of action and freedom of contract of the parties. The partnership-like arrangements in a close corporation include: giving each stockholder a single vote regardless of the number of shares, dividing profits so that salaries and dividends are allocated according to certain formulas, and establishing beforehand who will be elected to the board of directors. Treatment as a partnership permits close corporations to arrange their management, dividend, and arbitration agreements to conform to intended practice.

D. *Voting Agreements*

Another management control type arrangement is to permit voting pool agreements. The right to control voting by agreement between shareholders, which was formerly restricted in Delaware by the decision in the case of *Abercrombie v. Davies*,[82] has been broadened considerably so that a formal voting trust is no longer necessary, and practically any sort of pooling or similar agreement between shareholders is valid.[83] Both New York and Florida validate voting agreements and neither state's statute imposes a time limitation on them.[84] Delaware has a time limitation of ten years on voting agreements, but this is really unnecessary where all of the stockholders are parties to the voting agreement.[85]

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79. FLA. § 608.0103.

80. FLA. § 608.0105(2); DEL. § 354.

81. Bradley, *Toward a More Perfect Close Corporation—The Need for More and Improved Legislation*, 54 GEO. L.J. 1145, 1148-50 (1966).

82. *See* note 24 *supra*.

83. DEL. § 218.

84. N.Y. § 620(a); FLA. § 608.0105(1)(e).

85. DEL. § 218(a).

Voting agreements are superior to unanimity as a means of assuring election of each owner to the board, because deadlock is avoided. Furthermore, they provide greater flexibility and avoid the necessity of classes of stock. None of the three states, however, has a provision for the specific enforcement of these agreements.

It is interesting to note that, after Florida had enacted a separate close corporation statute, a Florida court in the case of *Thomas v. Sanborn* held a voting pool *within* a voting pool to be illegal, against public policy, and of no force and effect.[86] In that case a majority of the second voting pool could control the voting of the first voting pool, even though they constituted less than a majority of the first voting pool.

E. *Removal of Directors*

The Florida and New York statutes provide for the removal of directors without cause.[87] Delaware merely has a statutory section that refers to the possibility of the removal of directors.[88]

In New York, a provision allowing for the removal of a director without cause must be in the certificate, whereas in Florida, a director's removal without cause is permitted absent a contrary provision by agreement or in the by-laws or articles of incorporation.[89]

Nowhere in the Delaware General Corporation Law is there any answer to the questions of whether removal of directors is to be only with cause, whether there can be removal without cause (with or without such provision in the by-laws or certificate), or whether the by-laws or certificate may provide that directors cannot be removed. Delaware case law does allow removal for cause. The leading case is *Campbell v. Loew's*,[90] which held that stockbrokers have an inherent and unalterable right to remove directors for cause.

The absence from the Delaware statutes of any indication of the vaildity of a by-law or certificate provision permitting the removal of directors without cause raises other questions. If a court were to hold such a provision valid, it might also have to decide how to protect cumulative voting rights.[91]

If the court determined that directors can be removed only for cause or that special procedures must be utilized if there is to be removal without cause, the definition of what constitutes cause and the delineation of appropriate procedures for determining whether cause exists are crucial. The Delaware statute has neither a definition of cause nor delineation of appropriate procedures.

86. 172 So.2d 841 (Fla. 2d Dist. 1964).
87. FLA. § 608.0106; N.Y. § 706(b).
88. DEL. § 141(b).
89. Same as note 1 *supra*.
90. 36 Del. Ch. 563, 134 A.2d 852 (1957).
91. *See* N.Y. § 706(c)(1).

On the other hand, no Delaware statute prohibits the removal of directors without cause. In fact, one section states that "any provision . . . defining . . . the powers of the directors" can be inserted in the certificate if it is not contrary to the laws of Delaware.[92]

V. CONFLICT PRIVILEGES

Conflict privileges are designed to afford a remedy for stockholders of a close corporation which is stymied in deadlock or embroiled in hostility. Some of the conflict privileges are directed at breaking a deadlock.[93] Others permit the certificate of incorporation to grant a stockholder or group of stockholders an option to dissolve the corporation either at will or upon the occurrence of some specified contingency.

A. *Option to Dissolve*

The New York act specifically authorizes a petition for dissolution by any shareholder where deadlock prevents election of directors for two successive annual meetings.[94] However, the New York act also has restrictive provisions requiring, in all other cases of shareholder and director deadlock, petitions to be brought by the owners of one-half the shares, or one-third the shares if the charter contains a qualified-majority-voting provision.[95] The latter provision substantially undercuts the otherwise liberal approach of the New York legislation.

A major improvement over the provision of the New York statutes is found in the Florida dissolution sections. The Florida statute[96] allows dissolution upon the petition of "any" shareholder and provides for dissolution when the shareholders are deadlocked in voting power as well as when the directors are deadlocked over corporate policy. Involuntary dissolution irrespective of the cause or subject of deadlock is thereby permitted within the discretion of the circuit court. Thus Florida voids the questionable restriction of the New York act.

Notwithstanding the Florida provisions, the wording of the Delaware dissolution section is the most liberal of the three. The Delaware statute[97] permits the certificate of incorporation to grant to any shareholder, or to 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 by simply exercising the option and giving written notice thereof to all the other shareholders. If a certificate does not contain the foregoing provision it may be amended to include it

92. DEL. § 102(b)(1).

93. It permits a court of chancery to appoint a provisional director or appoint a custodian for the corporation.

94. N.Y. § 1104(c).

95. N.Y. §§ 1104(a), (b).

96. FLA. § 608.0107.

97. DEL. § 355(a).

by an affirmative vote of the holders of all the outstanding stock.[98] The only problem with the Delaware provisions occurs when the certificate requires the holding of a certain percentage of shares in order to exercise the option. Those shareholders who do not have the required percentage and who lack sufficient bargaining power to secure representation of their interests would not have enough power to prevent the other holders from coercing special concessions by threatening dissolution.

The increased possibility of deadlock caused by qualified-majority-voting, the restrictions on stock transfers, and the existence of only a limited market for shares in close corporations, require the availability of some method by which dissatisfied parties can withdraw. The foregoing provisions are consistent with a close corporation-partnership analogy and suggest that the approach to dissolution no longer depends entirely on the form of enterprise chosen.

One must keep in mind, of course, that there is a view opposing the desirability of the close corporation's having complete freedom of management and flexibility. The option-to-dissolve privilege seems to be adverse to the public interest in effective corporations because it allows a shareholder to dissolve an effective corporation at will. Some may feel it desirable to withhold the option when shareholders have a ready market for their shares.

It would appear that the need to protect private interests would outweigh society's interest in the preservation of corporations, where a shareholder cannot withdraw from a corporation which is acting contrary to his interests because there is no market for his shares.

B. *Breaking a Deadlock*

Delaware, in a major improvement over the provisions of the New York and Florida statutes, offers alternatives to dissolution. If a close corporation is managed by shareholders and there is a deadlock impairing the business of the corporation, a custodian may be appointed by the court of chancery.[99] This is supplementary to another new procedure whereby a custodian may be appointed by the court of chancery if the board of directors is deadlocked.[100] Alternatively, a provisional director may be appointed by the court of chancery to break a deadlock in the board of directors of a close corporation.[101] A provisional director differs from a custodian in that the former is only an additional director and control is left in the board, while the latter takes over the management of the corporation. This distinction is of importance with respect to issues as to which the board is not deadlocked in that a custodian could enforce a position contrary to that of a majority of the board while a provisional

98. DEL. § 355(b).
99. DEL. § 352.
100. DEL. § 226. This section also applies to publicly held corporations.
101. DEL. § 353.

director could not. It is also important as to issues with respect to which more than two positions may be taken. A custodian can enforce a position other than one of the two espoused by the respective sides of a deadlocked board, while a provisional director would not be able to do so except through compromise.

VI. Conclusion

As has been pointed out, the states which have legislatively ventured into the area of close corporation problems and privileges are few in number. Of the three states whose legislative attempts were compared in this paper, it is the writers' opinion that Delaware has passed the most complete set of provisions, and will have fewer problems arise under them than will Florida or New York. Florida was the first state to adopt a separate act, but the gaps left therein should now be filled.

New York, without a separate close corporation act, and other states completely lacking legislation in the area should consider the attempts of Delaware and Florida and draft legislation in the light of the criticism that has been made of those attempts.