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definitions of "past-due debts" include almost any situation where the check passes without the passer's simultaneous receipt of an article. Exclusion of past-due debts unduly restricts the operation of the statute.

A final proposal relates to the prevention of abuse of the criminal process by anxious creditors. First, restitution should not be a defense. Second, there should be some penalty available for those victims who avail themselves of the efforts of the prosecutor's office and the police department and later drop the charges. These suggestions, along with the proposal that the victim give notice of dishonor, would more adequately insure that only those victims who seriously seek to impose a criminal penalty, as opposed to those who seek to hasten payment, will initiate an action.

Insufficient funds checks present as substantial a problem to the prosecutor as they do to the commercial society. Nevertheless, while "bad checks" constitute nuisances to society, a viable criminal solution to the problem must be tempered by the basic constitutional rights of every citizen. An effective blend of these factors is possible only through a reasonable approach to the practical problems of insufficient funds prosecutions.

JAMES E. CROWE, JR.

MISSOURI CORPORATION STATUTES— NEEDED CHANGES FOR CLOSE CORPORATIONS

I. INTRODUCTION

The Uniform Partnership Act allows partners to fashion their own management and organizational structure to meet their individual needs.¹ Partners may agree on who will manage the business and who will be employed at what salary. Partners usually work together daily, and are aware of the skills and reliability of their fellow partners. Each partner may have a definite idea about the role he wishes to play in the business, and he may want to make this role a condition to his investment. Partners can give the business the desired measure of stability by agreeing as to when and upon what terms the partnership will be dissolved. In summary, partners have full freedom to contract as to the operation of their business.

Shareholders in a close corporation may have the same characteristics of mutual trust and close association as partners. In many cases, the shareholders will have operated as a partnership for many years. In the minds of the shareholders, the change to corporate form may be no more than a formality, represented by an inscrutable document on file in their lawyer's office. The nature of the association between the participants remains unchanged, and the shareholders may desire to tailor the structure of their business to their personal needs as they did in the partnership. The

1. See § 358.180, RSMo 1969, which makes it clear that the provisions of the statute governing relations between the partners are subject to any agreement between the parties.

obstacle to such agreements, when the parties operate as a corporation, is the "corporate norm." A zealous regard for the letter of the law has traditionally caused many courts to require rigid adherence to the structural and organizational arrangements set out in the corporate statutes. This structure has a Jeffersonian ring, embodying majority rule, representational role of directors and officers, and separation of power between the shareholders and directors.² While this structure serves well for large, publicly held corporations, where the dispersion of ownership requires a separation of ownership and management, it is poorly suited to the intimate associations that often characterize close corporations.³ Professor Latty has observed that "[a]ll this structure of representative government in the typical corporation law is about as appropriate for a two-man get-together as Robert's Rules of Order."⁴

The landmark case espousing the doctrine of "corporate norms" is *Jackson v. Hooper*.⁵ Jackson and Hooper purchased all the stock in a corporation and agreed that they would run it like a partnership and share control. There were five directors, but it was agreed that three of these would be dummy directors, leaving Jackson and Hooper as the only active directors. Contrary to the agreement, Jackson teamed up with the dummy directors and passed by-law provisions that deprived Hooper of his equal control. Hooper sued to enforce the agreement. The court held that public policy rendered the agreement void, stating:

The law never contemplated that persons engaged in business as partners may incorporate, with intent to obtain the advantages and immunities of a corporate form, and then, Proteus-like, become at will a copartnership or a corporation . . . They cannot be partners *inter sese* and a corporation as to the rest of the world.⁶

Some jurisdictions⁷ have adopted this doctrine; others⁸ have rejected it. In Missouri there is sufficient case law supporting strict application of the *Jackson* doctrine to cause stifling uncertainty. In *Taylor v. Baldwin*,⁹ a contract obligated the hospital board of directors to consult with another party in picking the hospital administrator. Although the court held that an agreement merely to *consult* was valid where the board remained free to exercise its discretion in choosing corporate officers, it also considered

2. See Kessler, *The Statutory Requirement of a Board of Directors: A Corporate Anachronism*, 27 U. CHI. L. REV. 696, 701 (1960).

3. "Like the Majestic evenhandedness of French justice by which rich and poor alike are forbidden to sleep under the bridges of Paris, strict enforcement of the corporate norms had a somewhat one-sided application." Chayes, *Madam Wagner and the Close Corporation*, 73 HARV. L. REV. 1532, 1533 (1960).

4. Latty, *The Close Corporation and the New North Carolina Business Corporation Act*, 34 N.C.L. REV. 432, 433 (1956).

5. 76 N.J. Eq. 592, 75 A. 568 (Ct. Er. & App. 1910).

6. *Id.* at 599, 75 A. at 571.

7. See *Long Park, Inc. v. Trenton-New Brunswick Theatres Co.*, 297 N.Y. 174, 77 N.E.2d 633 (1948); *Kaplan v. Block*, 183 Va. 327, 31 S.E.2d 893 (1944).

8. See *Wabash Ry. v. American Refrig. Transit Co.*, 7 F.2d 335 (8th Cir. 1925), cert. denied, 270 U.S. 643 (1926); *Elsbach v. Mulligan*, 58 Cal. App. 2d 354, 136 P.2d 651 (1943); *Hladovec v. Paul*, 222 Ill. 254, 78 N.E. 619 (1906); *Mendelsohn v. Leather Mfg. Corp.*, 326 Mass. 226, 93 N.E.2d 537 (1950).

9. 362 Mo. 1224, 247 S.W.2d 741 (En Banc 1952).

the line of cases following *Jackson* and in dictum agreed "with the principle stated in those cases that a contract is void which *precludes* a Board of Directors from exercising its prerogative to select or change the officers of a corporation."¹⁰ At least two other Missouri cases contain dicta to the same effect.¹¹

Recent statutory changes have recognized at least some of the distinctive needs of the close corporation. Typical of such changes are provisions in the Missouri statutes that allow (1) a single incorporator,¹² (2) a single director,¹³ and (3) the articles of incorporation to specify (a) the number of shareholders necessary for a quorum at shareholders' meetings,¹⁴ (b) the number of directors that constitute a quorum,¹⁵ and (c) the number of votes needed for director action.¹⁶

These provisions fall short of what is needed, however. It is not contended that the present Missouri statutes make it impossible for shareholders in a close corporation to fashion the management structure to their individual needs. Legal ingenuity has in most cases found a solution.¹⁷ Nevertheless, the present statutes require such legal and logical contortions to match the needs of the close corporation to the corporate mold that the law has become clouded with needless obscurity and complexity. Under the present statutes, the most dangerous thing for the parties to do is to sit down and make a straightforward agreement. Instead, the parties must consult a corporate specialist to clothe their agreement in legal subterfuge so it will pass statutory muster.

Therefore, the statutes are in need of further change if they are fully to meet the needs of the close corporation. After briefly discussing the problems of defining a "close" corporation, this comment will examine the further changes that are needed in the areas of shareholder voting arrangements, management by shareholders, restrictions on alienation of corporate shares, long-term employment contracts, dissolution and liquidation, and informality of operation.

II. PROBLEMS OF DEFINING WHAT CONSTITUTES A "CLOSE" CORPORATION

Some states¹⁸ have enacted special statutes covering only close corporations, but because of the difficulty of adequately defining the close corporation most states have rejected this approach.¹⁹ Any mechanical definition

10. *Id.* at 1245, 247 S.W.2d at 753.

11. *Sante Fe Hills Golf & Country Club v. Safehi Realty Co.*, 349 S.W.2d 27, 34 (Mo. 1961); *Leggett v. Missouri State Life Ins. Co.*, 342 S.W.2d 833, 851 (Mo. En Banc 1960).

12. § 351.050, RSMo 1969.

13. § 351.315, RSMo 1969.

14. § 351.265, RSMo 1969.

15. § 351.325, RSMo 1969.

16. § 351.325, RSMo 1969.

17. See F. O'NEAL, *CLOSE CORPORATIONS* (1972).

18. See DEL. CODE ANN. tit. 8, §§ 341-56 (1967); FLA. STAT. ANN. §§ 608.70-.77 (1963); MD. ANN. CODE art. 23, §§ 100-11 (Supp. 1971); N.C. GEN. STAT. §§ 55-1 to -175 (1955); PA. STAT. ANN. tit. 15, §§ 1371-86 (1968).

19. For a discussion of the difficulties of defining the close corporation see Note, *Corporations—Definition of the Close Corporation*, 16 VAND. L. REV. 1267 (1963). See also Folk, *The Model Act and the South Carolina Corporation Law*, 15 S.C.L. REV. 275, 282 (1963) (explaining the reasons for rejecting the separate

will inevitably be either too narrow or too broad. The problem of definition can be avoided in most cases by provisions that are theoretically available to all corporations but that as a practical matter will be used only by a genuine close corporation. In a few instances, however, it is necessary to limit provisions to the "close" corporation and to define that term.²⁰

No definition for a close corporation can be entirely adequate. Generally, statutes have taken one of two approaches in limiting provisions to close corporations. Definitions have been framed in terms of (1) a maximum number of shareholders²¹ or (2) a limitation on how the stock is traded.²² The shareholder number test is arbitrary. The addition of one more shareholder seldom changes the nature of the corporation. On the other hand, defining a close corporation as one whose shares are not generally traded on the market may be equally unsatisfactory. A corporation may have a wide dispersion of share ownership, thereby losing the characteristics of closeness, and still not be generally traded. Furthermore, because of its inherent lack of preciseness, the "generally traded" test makes it difficult to pinpoint exactly when a corporation crosses the line and is no longer close.²³

All things considered, the "numbers" test seems to be best. Setting a number is not entirely arbitrary, because businessmen are influenced by Subchapter S of the Internal Revenue Code,²⁴ which taxes a corporation similarly to a partnership if among other requirements there are 10 or fewer shareholders. The numbers test has precision and certitude that cannot be had with the no-trade definition. The large numbers of corporations electing Subchapter S attests to the fact that the numbers test is workable.²⁵

III. SPECIFIC AREAS IN WHICH CHANGE IS NEEDED

A. Validity of Shareholder Voting Agreements

Almost without exception, the early cases held shareholder voting

statute in the drafting of the South Carolina statute); Hoffman, *New Horizons for the Close Corporation in New York Under its New Business Corporation Law*, 28 BROOKLYN L. REV. 1, 2 (1961).

20. See text accompanying note 34 *infra* and text following note 91 *infra*.

21. Two statutes authorize stock transfer restrictions if shares are owned by not less than 20 shareholders. See TEX. BUS. CORP. ACT. ANN. art. 22.22 (b) (2) (1955); WYO. STAT. ANN. § 17-36.32 (d) (1965).

22. FLA. STAT. ANN. § 608.70 (2) (1963); N.Y. BUS. CORP. LAW § 620 (c) (McKinney 1961); N.C. GEN. STAT. § 55-73 (b) (1955); S.C. CODE ANN. § 12-1622 (c) (1962). The Maryland statute takes the direct approach of defining a close corporation as one whose charter contains a statement that it is a close corporation. Such a statement requires 100 percent shareholder consent. MD. ANN. CODE art. 23, § 100 (a) (1967).

23. See F. O'NEAL, CLOSE CORPORATIONS § 1.02, n.6 (1972). The Delaware statute solves this problem by terminating close corporation status either 30 days after the act causing loss of eligibility or 30 days after discovery of such an act, whichever is later. DEL. CODE ANN. tit. 8, § 348 (a), (b) (1967).

24. INT. REV. CODE OF 1954, § 1371 (a) (1).

25. In 1970, 12 percent of active American corporations (173,000 out of 1,424,000) were electing Subchapter S taxation. H. HENN, LAW OF CORPORATIONS § 262, at 521 n.3 (1970).

agreements invalid.²⁶ The power to vote was considered inseparable from the ownership of the share; further, shareholders were considered to have contracted for each other's independent and unfettered judgment at shareholders' meetings.

A sharp change in judicial attitude came about 1910.²⁷ Today, if there is a proper purpose, shareholder agreements on how shares will be voted are generally enforceable.²⁸ The Missouri statute sanctions one device, the voting trust, that will effect an enforceable agreement on shareholder voting. This statute, probably the most liberal of any in the United States, reads as follows:

Any number of shareholders of a corporation may create a voting trust for the purpose of conferring upon a trustee or trustees the right to vote or otherwise represent their shares, for any period²⁹

Since the voting trust statute does not require unanimity, it is incompatible with the basic pattern of the close corporation. From a shareholder's point of view, a close corporation is similar to a partnership with the cloak of limited liability. Shareholders in a close corporation need the same fiduciary relationship as partners in a partnership.³⁰ Each partner owes a fiduciary duty to the other partners.³¹ This fiduciary relationship should foreclose internecine alliances in the partnership unless all partners agree. The situation in Missouri is particularly unsatisfactory because the Missouri statute³² lacks a disclosure requirement.³³ A minority shareholder may believe that he has equal rights with his other associates in management and later find to his dismay that they have combined against him. To protect the close corporation from these divisive results, 100 percent shareholder consent should be required for voting trusts in close corporations.³⁴

26. *Perry v. Missouri-Kan. Pipe Line Co.*, 22 Del. Ch. 33, 191 A. 823 (1937); *Morel v. Hoge*, 130 Ga. 625, 61 S.E. 487 (1908); *Luthy v. Ream*, 270 Ill. 170, 110 N.E. 373 (1915); *Lothrop v. Goudeau*, 142 La. 342, 76 So. 794 (1917); *Warren v. Pim*, 66 N.J. Eq. 353, 59 A. 773 (Ct. Err. & App. 1904); *Roberts v. Whitson*, 188 S.W.2d 875 (Tex. Civ. App. 1945). See also Annots., 45 A.L.R.2d 799, 821-23 (1956), 71 A.L.R. 1289, 1293-95 (1931).

27. See F. O'NEAL, *CLOSE CORPORATIONS* § 5.04 (1972).

28. See cases collected at Annot., 45 A.L.R.2d 799 (1956).

29. § 351.246, RSMo 1969. This statute has yet to be judicially interpreted.

30. Some commentators suggest that a fiduciary relationship among close corporation shareholders should be established by statute. See F. O'NEAL, *CLOSE CORPORATIONS* § 1.14 (c); Bradley, *Toward a More Perfect Close Corporation—The Need for More and Improved Legislation*, 54 GEO. L.J. 1145, 1188 (1966). For cases recognizing the fiduciary relationship see *Helms v. Duckworth*, 249 F.2d 482, 486 (D.C. Cir. 1957) (opinion by Circuit Judge Warren Burger); *Application of Pivot Punch & Die Corp.*, 15 N.Y. Misc. 2d 713, 716, 182 N.Y.S.2d 459, 463 (Sup. Ct. 1959). See also Hetherington, *Special Characteristics, Problems and Needs of the Close Corporation*, 1969 ILL. L. FORUM 1, 6-7, where the author observes that the effect of shareholder agreements by less than 100 percent may be minority oppression.

31. § 351.210, RSMo 1969.

32. § 351.246, RSMo 1969.

33. See Bradley, *supra* note 30, at 1173 n.91, where the author questions the wisdom of secret voting trusts even for the non-close corporations.

34. See text accompanying notes 21 & 22 *supra* for possible definitions of "close corporation." In contrast to the close corporation situation, voting agreements in large publicly held corporations can be useful with less than 100 percent

In substance, a shareholders voting agreement and an irrevocable proxy are indistinguishable from a voting trust. All three devices are different methods to the same end—an enforceable contract among shareholders. Therefore, the law should treat these three devices in the same way. This, however, is not the case. Although the validity of the proxy has been established by statute,³⁵ the proxy may be revocable even though it states the contrary, because it is viewed as creating the relationship of principal and agent.³⁶ Under the principles of agency law, however, a proxy may be irrevocable if coupled with an interest.³⁷ Pursuant to this concept, it has been held that a proxy giving voting power as security for a loan to the corporation is a sufficient interest to make the proxy irrevocable.³⁸ Where a proxy-holder has been induced to become a substantial shareholder by a promise of voting control, the agreement has been held valid.³⁹ It is unsettled whether proxies given in exchange for mutual promises among shareholders can qualify as proxies coupled with an interest.⁴⁰

The present law on irrevocable proxies is unsatisfactory because of the uncertainty as to what type of interest will support irrevocability. Missouri needs a statute similar to New York's,⁴¹ which removes this uncertainty by avoiding the "coupled-with-an-interest" test. The statute states that a proxy is irrevocable if it so states and is held by (1) a pledgee, (2) a purchaser of the shares, (3) a creditor, (4) an officer of the corporation if the proxy is conditioned on employment, or (5) parties to a voting agreement. The evils of intramural alliances in close corporations using irrevocable proxies coincides with the evils of a voting trust and, therefore, proxies should be irrevocable in close corporations only if there is 100 percent consent.

There is no reason why a shareholder's voting agreement should have to be cast in the form of a proxy agreement or voting trust in order to be effective.⁴² In fact, proxy agreements and voting trusts were created as substitutes for naked voting agreements, which had met judicial opposition.⁴³ The substitutes have now become well-recognized, and the "real thing"—the simple unadorned agreement—should be given the same recognition.

consent. A group of minority shareholders with a common interest may combine to elect a favorable director without unfair consequences.

35. § 351.245, RSMo 1969.

36. 18 C.J.S. *Corporations* § 550 (g) (1939).

37. *Id.*

38. *Chapman v. Bates*, 61 N.J. Eq. 658, 47 A. 638 (Ct. Err. & App. 1900).

39. *Hey v. Dolphin*, 92 Hun. 230, 36 N.Y.S. 627 (Sup. Ct. 1895).

40. See F. O'NEAL, *CLOSE CORPORATIONS* § 5.11 (1971); Comment, *Irrevocable Proxies*, 43 TEXAS L. REV. 733, 742-45 (1965).

41. N.Y. BUS. CORP. LAW § 609 (f) (McKinney 1963). See also S.C. CODE ANN. § 12-16.14 (f) (5) (1962).

42. The following statutes recognize this by validating the unadorned shareholder's agreement: DEL. CODE ANN. tit. 8, § 218 (c) (Supp. IV, 1971); FLA. STAT. ANN. § 608.75 (3) (1963); N.J. REV. STAT. § 14A: 5-21 (1) (1969); N.Y. BUS. CORP. LAW § 620 (a) (McKinney 1963); N.C. GEN. STAT. § 55-73 (a) (1965); PA. STAT. ANN. tit. 15, §§ 1381-82 (Supp. 15, 1973); TEX. BUS. CORP. ACT art. 2.30 (b) (Supp. 3A, 1972).

43. See Bradley, *Toward a More Perfect Close Corporation—The Need for More and Improved Legislation*, 54 GEO. L.J. 1145, 1167, 1172 (1966).

B. Management by Shareholders

The provision in the Missouri statute⁴⁴ that "[t]he property and business of a corporation shall be controlled and managed by a board of directors" is substantially identical to provisions in the vast majority of statutes of other states.⁴⁵ Courts have taken notice of the mandatory language of the statute and have often invalidated shareholders' agreements attempting to shift the management power from the board of directors to the shareholders.⁴⁶

In *Kaplan v. Block*,⁴⁷ a provision in the articles of incorporation stated that no act of the board of directors would be valid unless ratified by all of the shareholders. The court noted that the effect of such an agreement was to transfer the power to manage from the board of directors to the shareholders. Such a result, the court said, was against the public policy expressed in the Virginia statute that the board of directors shall manage.

It seems doubtful that such an agreement injures any state interest. If the parties believe that some form of management structure other than the traditional "shareholder-director-officer" scheme better serves their needs, the interest of the state is not thereby infringed. The state has an interest in protecting all shareholders from abuses of irresponsible management, and the best way to protect a shareholder from such abuses is to allow him to protect himself by contractually securing the rights he desires. Legal scholars have pointed out that an inviolate board of directors is not intrinsically imbedded in corporate law.⁴⁸ The United States Supreme Court has stated the general rule "that except in cases where the charter imposes a limitation the stockholders are the proper parties to take final action in the management of corporate affairs."⁴⁹ One author has suggested that statutory provisions that the board of directors shall manage were designed merely as a concession to normal business practice, rather than as a mandatory requirement.⁵⁰

For close corporations a mandatory board of directors is clearly undesirable. The parties generally regard themselves as partners. The board of directors is no more than a paper entity to preserve the facade of "corporateness" so that the "partners" can invoke limited liability. The following quote illustrates the "wonderland" quality of the board of directors:

One of the "partners" will order necessary supplies for the business, without stopping to consider whether he has technical authority to do so as secretary, or treasurer, or as holder of whatever "office" was parceled out to him to satisfy the requirements of the corporate mold. He will tell his co-partners . . . when he

44. § 351.310, RSMo 1969.

45. See Kessler, *The Statutory Requirement of a Board of Directors: A Corporate Anachronism*, 27 U. CHI. L. REV. 696, & n.1 (1960).

46. See, e.g., *McQuade v. Stoneham*, 263 N.Y. 323, 189 N.E. 234 (1934). For the Missouri position, see text accompanying notes 9-11 *supra*.

47. 183 Va. 327, 31 S.E.2d 893 (1944).

48. See Kessler, *supra* note 45, at 702-08.

49. *Union Pac. Ry. v. Chicago, R.I. & Pac. Ry.*, 163 U.S. 564, 600 (1896).

50. See Kessler, *supra* note 45, at 704.

has returned, of his acts. Each will separately say "O.K., Joe, whatever you think we need," without stopping to consider whether the purchase requires action by the board of directors convened as a board to authorize the contract.⁵¹

A few states⁵² have changed their statutes to allow shareholder management if the shareholders so desire. The New York statute⁵³ provides that the articles of incorporation may transfer the power to manage the corporation to persons other than the board of directors if all of the incorporators or subscribers or all of the shareholders, whether voting or nonvoting, have authorized the provision. The provision, the existence of which must be conspicuously noted on the share certificate, relieves the directors of liability and imposes it on the shareholders for any acts that the provision covers. The provision automatically lapses if the shares are traded on a national exchange, regularly quoted over-the-counter, or sold to persons who have no notice of the provision. Such a provision may be removed by a vote of two-thirds or such larger proportion of shares as may be required by the articles. Theoretically, this transfer of power is available to all corporations, but practically only close corporations will use it because of the unanimity requirements.

The automatic lapse provision in the New York statute is a source of problems. One cannot be sure when shares are "regularly quoted over-the-counter" or "traded on a national exchange." The statute could be improved by removing any provision for automatic lapse and allowing lapse by a two-thirds vote or at the insistence of any shareholder who bought without notice. This assures that all parties know of the lapse and puts them on notice that management must be revested in the board of directors.⁵⁴

C. *Restrictions on Alienation*

A close corporation is usually characterized by identity of ownership and management, as distinguished from a publicly held corporation where management is left to the board of directors. Because the owners of a close corporation may work intimately together in the daily operation of the business, they should be free to choose their associates.⁵⁵ The ability of shareholders to place restrictions on transferability of shares in order to prevent transfer to incompatible persons is essential to the close corporation.

Reasonable restrictions on transfer are upheld almost everywhere.⁵⁶ The principal problem with the "reasonable restrictions" test is its uncertainty. The Missouri case law illustrates this uncertainty. Early Missouri

51. *Id.* at 717.

52. See DEL. CODE ANN. tit. 8, § 351 (1967); FLA. STAT. § 608.72 (1973); MD. ANN. CODE art. 23, § 105 (1967); N.Y. BUS. CORP. LAW § 620 (b) (McKinney 1961); N.C. GEN. STAT. §§ 55-24 (b), 55-73 (b) (1965); P.R. LAWS ANN. tit. 14, § 1102 (b) (1962).

53. N.Y. BUS. CORP. LAW § 620 (b) (McKinney 1961).

54. See note 23 *supra* for the Delaware solution to inadvertent change of status.

55. See Bradley, *supra* note 43, at 1178.

56. Painter, *Stock Transfer Restrictions: Continuing Uncertainties and a Legislative Proposal*, 6 VILL. L. REV. 48 (1961).

cases⁵⁷ upheld agreements restraining transfer by a shareholder-creditor of the corporation until the debt was paid. Today in Missouri, the only other restraint with explicit judicial approval is one giving a first option to the corporation.⁵⁸ Any deviation from these sanctioned agreements runs the risk of being held unreasonable. Thus, associates in close corporations enter into transfer restrictions agreements at their peril.

Some states⁵⁹ have enacted statutes to remove this uncertainty. Among the most comprehensive is the New Jersey statute.⁶⁰ It provides that any reasonable restriction on the transfer of shares may be enforced if the restriction is in the articles, by-laws, an employee benefit plan, or a written agreement between any number of shareholders and the corporation. A restriction cannot be imposed upon a nonconsenting present owner, and unless the restriction is noted conspicuously on the face of the security it is invalid against one who becomes an owner without knowledge of its existence. To this point the statute is an approximate restatement of the law of Missouri and most other jurisdictions. But the New Jersey statute goes on to remove the uncertainty found in the Missouri law in two important ways. First, the statute enumerates five types of agreements that are not unreasonable. This removes the uncertainty of the "reasonable restriction" test, at least with respect to the enumerated restrictions. Further, the statute provides that if an agreement is held to be unreasonable the corporation shall nevertheless have an option for 30 days after the judgment becomes final to buy the share at a price agreed upon by the parties or, if no agreement is possible, then at a price determined by the court.

The New Jersey statute provides for most of the needs of close corporations. It specifically allows the most common types of restraints. It authorizes restrictions that require an offer to be made to the corporation or to other designated persons before the stock can be sold to another. It also authorizes a restriction that obligates a named party to buy shares when offered, and it permits contracts that forbid transfer without the consent of the corporation or of particular classes of security holders. It also validates contracts that prohibit transfers to designated individuals or classes of individuals. These provisions or combinations thereof give the parties the same freedom to choose their business associates that is now possible in the partnership form. Further, the comments make it clear that the enumerated provisions are not intended to be exclusive.⁶¹

A few states⁶² have comprehensive statutes comparable to the New

57. See, e.g., *St. Louis Perp. Ins. Co. v. Goodfellow*, 9 Mo. 149 (1845); *Kretzer v. Cole Bros. Lighting Rod Co.*, 193 Mo. App. 99, 181 S.W. 1066 (St. Louis Ct. App. 1916).

58. *State ex rel. Huffman v. Sho-me Power Co-op.*, 356 Mo. 832, 204 S.W.2d 276 (En Banc 1947) (relying in part on Uniform Stock Transfer Act, § 563.15, RSMo 1969, to validate a restriction requiring the shareholder to give a 30-day option to the corporation before selling to another); *Scruggs, Vandervoort & Barney Bank v. International Shoe Co.*, 52 S.W.2d 1027 (St. L. Mo. App. 1932) (option of corporation to buy stock held valid).

59. See statutes cited notes 62 & 63 *infra*.

60. N.J. STAT. ANN. § 14A: 7-12 (1969).

61. N.J. STAT. ANN. § 14A: 7-12, Comments at 458 (1969).

62. DEL. CODE ANN. tit. 8, §§ 341 to -56 (1967); TEX. BUS. CORP. ACT art. 2.22 (Supp. 3A, 1972); WYO. STAT. ANN. § 17-36.32 (1957).

Jersey statute. A few other statutes suggest that some restrictions are possible by providing that restrictions may be placed in the by-laws or charter.⁶³ This latter approach, however, does not deal with the uncertainties of the "reasonable restriction" test. Most states,⁶⁴ including Missouri, make no statutory reference to the problem of restrictions on transfer.

D. Long-Term Employment Contracts

A person considering investing in a close corporation may insist on permanent employment as a condition to his becoming a shareholder. Shareholders often expect to devote their full time to management of the corporation and are unwilling to invest unless they are assured of a permanent job with participation in management. Furthermore, it is generally the practice in close corporations to distribute a high percentage of corporate profits as salary rather than dividends. Therefore, in order to get a fair return on his investment a minority shareholder must be assured of permanent employment.⁶⁵

It is difficult to draft a reliable agreement guaranteeing long-term employment. Many courts have indicated that contracts with a corporation for employment for long or indefinite periods are invalid because they improperly bind the hands of future boards of directors.⁶⁶ These courts have reasoned that because the statutes give the board of directors power to manage the corporation and because the board is elected periodically a new board should be able to effectuate completely new management. Long-term employment contracts may also run afoul of corporate statutes that allow removal of corporate officers and employees at the pleasure of the board of directors. The Missouri statute,⁶⁷ for example, states that "any officer or agent . . . may be removed by the board of directors whenever in its judgment the interests of the corporation would be served . . ."

Even if a court finds that the agreement is valid there can generally be no specific performance of employment contracts.⁶⁸ Courts and lawmakers have wisely refused to force people into relationships requiring mutual trust and confidence. No state has changed this policy to protect shareholder/employees in close corporations.

While the shareholder/employee in a close corporation cannot get complete satisfaction by specific performance, some changes can be made. The Missouri statute provides that every corporation shall have a president and secretary who "*shall be chosen by the board of directors.*"⁶⁹ A Missouri

63. See, e.g., CAL. CORP. CODE § 501 (g) (1955); GA. CODE ANN. § 22-802 (b) (1) (1970); IOWA CODE ANN. § 496A.49 (8) (1962); PA. STAT. ANN. tit. 15, § 1613 (A) (1967).

64. See F. O'NEAL, CLOSE CORPORATIONS § 7.06 (a) for a discussion of statutes in this area.

65. *Id.* at § 6.02.

66. *Borland v. John F. Sass Printing Co.*, 95 Colo. 53, 32 P.2d 827 (1934); *Wilson v. Jennings*, 344 Mass. 608, 184 N.E.2d 642 (1962); *Clifford v. Firemen's Mut. Benevolent Ass'n*, 232 App. Div. 260, 249 N.Y.S. 713 (1931), *aff'd mem.*, 259 N.Y. 547, 182 N.E. 175 (1932).

67. § 351.365, RSMo 1969.

68. See e.g., *Richardson v. Ozark Air Lines*, 270 S.W.2d 8 (Mo. 1954).

69. § 351.360, RSMo 1969.

case⁷⁰ suggests that the board may not bind future boards to long term employment for officers but they may bind future boards to the long-term employment of an employee such as a general manager. The Missouri statute should validate employment contracts for officers as well as other employees if all shareholders agree. Although the officer could still be removed, his contract right would be preserved to support an action for damages.⁷¹

E. *Specific Performance of Shareholder Agreements*

Traditionally, courts were reluctant to grant specific performance of shareholder agreements.⁷² Most of the recent case law,⁷³ however, supports such relief. Professor Bradley suggests that shareholder agreements are of little use unless specific performance is assured and that statutes should direct courts to grant specific performance.⁷⁴ Bradley argues that such a provision is needed to supply certainty in the law, and points out that damages may be an entirely inadequate remedy to compensate for loss of control of a corporation. In the absence of specific performance the agreement may be an empty promise. Professor Chayes,⁷⁵ on the other hand, believes that a blanket rule granting specific performance is unwise. He considers specific performance to be judicially enforced intimacy. Specific enforcement of shareholder agreements for employment is generally denied because of the public policy against forcing unwilling parties into consensual relationships.⁷⁶ Chayes points out that other types of shareholder agreements may also force parties into intimate relationships requiring mutual trust and confidence. As an example, specific enforcement of a contract restricting sale of stock can force parties into continuing a relationship that may be more intimate than a mere employer-employee relationship. The parties may work together daily in making decisions that require a high degree of compatibility.

Thus, two legitimate policies are in conflict: (1) The policy of giving an adequate remedy for breach of contract; and (2) the policy against forcing parties into relationships requiring mutual trust and confidence. A balancing of these two policies requires that, if the law forces the parties into close quarters dictated by a shareholder's agreement, the law should also provide an escape, in the form of dissolution, if the terms of the agreement become intolerable. The Maryland statute⁷⁷ attempts such a balance:

A shareholder's agreement . . . may, in the discretion of a court of equity, be enforced by injunction or by such other relief as the

70. *Streett v. Laclede-Christy Co.*, 409 S.W.2d 691 (Mo. 1966).

71. The Missouri statute expressly provides for preservation of contract rights. See § 351.365, RSMo 1969.

72. See 5 FLETCHER, *CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS* § 2067 (1967).

73. *Id.*

74. See Bradley, *supra* note 43, at 1163.

75. Chayes, *Madame Wagner and the Close Corporation*, 73 HARV. L. REV. 1532 (1960).

76. *Richardson v. Ozark Airlines*, 270 S.W.2d 8 (Mo. 1954). See also F. O'NEAL, *CLOSE CORPORATIONS* § 6.05 n.8 (1971).

77. MD. STAT. ANN. art. 23, § 104 (d) (1973).

court may determine to be fair and appropriate in the circumstances. As an alternative to the granting of an injunction or other equitable relief, the court may upon the motion of a party to the proceeding order the dissolution⁷⁸

This statute gives a court a great deal of flexibility. First, it leaves the option of awarding only money damages for breach of the agreement, but makes it clear that a second alternative, specific performance, is also available. Presumably the statute incorporates the principle of equity that specific performance is available only when damages are an insufficient remedy.⁷⁹ The third option offers the greatest relief to the close corporation shareholder. If damages are an insufficient remedy, specific performance should be ordered, but the statute recognizes that the confines of the agreement may force the parties into intolerable intimacy. If such is the case, the unwilling party can ask for dissolution.⁸⁰ The Maryland statute could be improved by making it clear that if there is a dissolution, money damages for breach of contract are available.

F. Dissolution and Liquidation

A major problem for a minority shareholder in a close corporation may be protecting himself in case of dissension or abuse by the majority. In a partnership, the holder of a minority interest can use his power to compel liquidation as a weapon against actions contrary to his interest. Further, partners may contractually arrange the conditions and terms of liquidation. In contrast, a minority corporate shareholder may be faced with a statute that requires more than 50 percent shareholder consent to effect a voluntary dissolution. This requirement, coupled with the limited market for a minority interest in a close corporation, leaves a minority shareholder "locked in" and virtually powerless against majority shareholders.⁸¹

The Missouri statute allows voluntary dissolution by a vote of all the shareholders⁸² or by resolution of the board of directors and a vote of two-thirds of the shareholders.⁸³ There are no cases indicating whether this is the exclusive means of dissolution or merely a method to operate in the absence of a shareholders' agreement on dissolution. The weight of authority from other jurisdictions, however, holds that a corporation cannot be dissolved except in a manner prescribed by statute.⁸⁴

It should be noted that a contractual dissolution can probably be arranged in Missouri by ingenious counsel. The parties can agree that

78. Involuntary dissolutions are governed by MD. STAT. ANN. art. 23, § 109 (1973). See text accompanying note 92 *infra*.

79. H. McCLINTOCK, PRINCIPLES OF EQUITY § 60 (2d ed. 1948).

80. Under the Maryland statute the court may decree dissolution if "[t]here is such internal dissension among the stockholders of the corporation that the affairs of the corporation can no longer be conducted to the advantage of the stockholders generally." MD. STAT. ANN. art. 23, § 109 (1973).

81. See Comment, *Rights of the Minority Shareholders to Dissolve the Closely Held Corporation*, 43 CALIF. L. REV. 514, 516-17 (1955).

82. § 351.460, RSMo 1969.

83. § 351.465, RSMo 1969.

84. See 16a FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 8013 (1962).

the trustee of a voting trust shall vote for dissolution upon the occurrence of an agreed event.⁸⁵ Because there are no Missouri cases, this method is unreliable for planning purposes; it is open to the challenge that it conflicts with the statutory norm. An agreement among shareholders that the trustee of a voting trust shall liquidate and distribute the assets (leaving an empty corporate shell) upon a stated contingency is also probably valid, but again the validity is uncertain because it may run afoul of the "director shall manage" mandate.⁸⁶ Buy out provisions may also give some protection to an oppressed minority. The disadvantage of this device is that a shareholder with ready assets may provoke dissension to force the minority to use their sellout option.⁸⁷ The result is that in Missouri the minority shareholder has no satisfactory protection against abuse by the majority.

Several states⁸⁸ have enacted statutes that allow shareholders to provide for contractual dissolution. The New Jersey statute reads:

The certificate of incorporation may provide that any shareholder, or any specified number of shareholders . . . may effect the dissolution of the corporation at will or upon the occurrence of a specified event.⁸⁹

The statute also deals with the vote required for amendments adding or deleting such a provision and the problems of notice of the provision to subsequent purchasers. This type of statute would remove the uncertainties in the present Missouri law. Because such contracts providing for dissolution require consent of all shareholders, their use is practically limited to close corporations.

A more liberal statute on involuntary liquidation is also needed in Missouri for the minority shareholder who fails to protect himself by contractual dissolution.⁹⁰ The present Missouri statute⁹¹ gives equity courts power to *liquidate* the assets of the corporation upon suit by a shareholder when it appears (a) that there is a deadlock in the management and that irreparable injury is being suffered or threatened thereby, or (b) the acts of those in control are illegal, oppressive, or fraudulent, or (c) the corporate assets are being misapplied or wasted. While these limited grounds for involuntary liquidation provide stability for the publicly held corporation, they can be a serious obstacle for the minority shareholder in a closely held corporation. Even though there is no oppression, no deadlock, and no waste, the minority shareholder may find his situation entirely unsatisfactory. The atmosphere of trust and confidence that accompanied the launch of their venture may have completely dissi-

85. See F. O'NEAL, CLOSE CORPORATIONS § 9.06 (1971).

86. See text accompanying notes 44 & 45 *supra*.

87. See F. O'NEAL, CLOSE CORPORATIONS § 9.05 (1972).

88. DEL. CODE ANN. tit. 8, § 355 (a) (1969); N.J. STAT. ANN. § 14A:12-5 (1969); N.Y. BUS. CORP. LAW § 1002 (McKinney 1963); N.C. GEN. STAT. § 55-125 (3) (1966); S.C. CODE ANN. § 12-2214 (1962).

89. N.J. STAT. ANN. § 14A:12-5 (1969).

90. For a good discussion on the need for self-executing protection for the minority shareholder see Hetherington, *Special Characteristics, Problems, and Needs of the Close Corporation*, 1969 ILL. L. FORUM 1, 15.

91. § 351.485, RSMo 1969.

pated and been replaced by open hostility. In such a situation, the minority shareholder should be able to withdraw his investment through an involuntary liquidation.

An example of the statutes designed to allow this is the Maryland statute.⁹² It allows dissolution of a close corporation on the ground that "there is such internal dissention among the stockholders of the corporation that the affairs of the corporation can no longer be conducted to the advantage of the stockholders generally." The statute further provides that if any of the shareholders wish to continue the business they may avoid dissolution by purchasing the stock of the petitioner at its fair value. To maintain the stability of the non-close corporation, this provision should be available only to the close corporation.

G. Informality of Operation

According to traditional corporation doctrine, neither directors nor shareholders may act except at duly called meetings that conform to statutory standards of formality.⁹³ The Missouri statute⁹⁴ is fairly liberal in allowing informality at directors' meetings. It allows the by-laws to specify the type of notice required, provides that attendance at a meeting constitutes a waiver of notice, and provides that written consent *in advance* to any action to be taken by the board constitutes valid board action. The Missouri statutes⁹⁵ on shareholders meetings are more rigid, however. For example, written notice of each shareholders' meeting, stating the day, hour, and purpose must be given to each shareholder not more than 50 days or less than 10 days before the meeting.⁹⁶ In addition, notice must be published.⁹⁷

These statutory formalities are often ignored in close corporations.⁹⁸ The shareholders may work together daily and have general knowledge of what actions are being taken. If a shareholder disagrees with actions to be taken, he usually has an opportunity to object. The parties may wish to spend little time on paper work and may justifiably feel that such a formality is unnecessary to protect an owner who is intimately involved in management.⁹⁹

A disregard of these formalities, however, may lead to serious legal consequences. If a court finds that the corporate entity was a mere conduit for the shareholders to transact their own affairs, it may disregard the corporate entity if necessary to do justice.¹⁰⁰ Disregard of the corporate

92. MD. STAT. ANN. art. 23, § 109 (Supp. 2, 1971).

93. H. BALLANTINE, CORPORATIONS §§ 44, 170 (Rev. ed. 1946).

94. § 351.340, RSMo 1969.

95. See generally §§ 351.225-235, RSMo 1969.

96. § 351.230 (1), RSMo 1969.

97. § 351.230 (2), RSMo 1969.

98. It should be noted that the close corporation has the same need for complete and accurate financial records as a larger corporation. The cumbersome machinery necessary for valid corporate action, however, is inappropriate for the close corporation.

99. See e.g., *Silverman v. Gilbert*, 185 So. 2d 373 (La. App. 1966) (by-laws were never adopted).

100. See I FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS §§ 41-44 (1963).

entity may result in loss of limited liability, which may be the primary purpose for organizing the corporation.¹⁰¹

The North Carolina Corporation Act¹⁰² contains detailed provisions designed for close corporations. Acts taken by a majority of directors or a majority of the members of a committee without a meeting are nevertheless valid if (1) all directors or members of the committee consent in writing either before or after¹⁰³ the action, or (2) all shareholders know of the action and make no prompt objection, or (3) the directors or committee members are accustomed to informal action, the custom is generally known to the shareholders,¹⁰⁴ and prompt objection to the informal action is not made by a director or committee member.¹⁰⁵

The North Carolina act has similar provisions for informal shareholder action. The statute¹⁰⁶ provides that any meeting of shareholders is valid, however called and with whatever notice, if (1) all shareholders are present in person or by proxy and no objection to holding the meeting is made, or (2) a quorum is present in person or by proxy and all absent shareholders sign a written waiver of notice or consent to the action taken, or (3) all parties entitled to vote consent in writing to action taken without a meeting either before or after the action. While the informal proceedings are theoretically available to all corporations, they will practically be available only to close corporations because of the requirement that all shareholders manifest consent.

IV. CONCLUSION

The above changes to the Missouri statute should enable the owners of a close corporation to structure it according to their needs. The primary vehicle to allow this structural freedom is the shareholder's agreement. If the shareholder's agreement is freed from the shackles of the "corporate norm," the parties can decide how their corporation will be managed and embody their decision in an enforceable contract. The most troublesome of the "corporate norms" is the slavish service to the statutory provision that the "directors shall manage." The statute should make it clear that the close corporation can be free of the "shareholder-director-officer" management structure and that its management can be contractually structured.

101. *Id.*

102. N.C. GEN. STAT. §§ 55-1 to -175 (1965). Other statutes designed to give relief to the close corporation are: KAN. STAT. ANN. § 17-7201-16 (Supp. 1972); TEX. BUS. CORP. ACT art. 9.09 (1956); VA. CODE ANN. § 13.1-27 (1973).

103. In Missouri, it appears that written consent is a substitute for a meeting only if made before the action is taken:

If all the directors . . . consent in writing to any action to be taken by the directors, such consent shall have the same force and effect as a unanimous vote of the directors at a meeting duly held . . . § 351.340 (2), RSMO 1969 (emphasis added).

There are no cases interpreting this provision.

104. A 1959 amendment substituted "generally known to shareholders" for "known to all shareholders." This amendment could allow informal action for relatively large corporations and has potential for abuse.

105. N.C. GEN. STAT. § 55-29 (1965).

106. N.C. GEN. STAT. § 55-63 (1965).