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FOREWORD

This symposium is an attempt to explore certain aspects of what is commonly called a close corporation. At the very outset difficulty arises in determining what is meant by this term. For example, the close corporation is usually identified with small business, and undoubtedly most such organizations are small businesses, but there have been and still are many notable exceptions in this country.

Another fact emphasized in attempting to define the close corporation, is that irrespective of the size of the business the stock of the corporation is closely held, that is, it is owned and controlled by a small number of individuals, frequently all members of one family group, and sometimes even by a sole shareholder. Such close ownership of the stock has certain important consequences. Obviously the stock will not be listed on any public exchange. Furthermore, it will not even be handled on over-the-counter markets because transfers or sales of it inevitably will be highly infrequent and usually within the family or other controlling group. To maintain and enforce this ownership usually there will be restrictions on the sale or transfer of the shares, based upon provisions in the certificate of incorporation, the by-laws, or stockholder agreements and options. From this standpoint, not only is stock closely held but also ownership of it is closed to those outside the favored or family group.

Another typical characteristic of the close corporation is that, unlike the publicly owned one, its ownership, control, and management are centralized and unified in one group, namely the shareholders. There usually is no division between the shareholder-owners and the director-managers. Either the stockholders themselves are the directors, or they so closely dominate and control the directors that the latter are in fact little more than their agents. Frequently the shareholders go even further, and besides being directors are also the officers and executives of the company. In any event, either through serving as the directors and officers themselves or through detailed provisions in the charter, by-laws, or stockholder agreements, the shareholders personally manage and control the business directly or else perform these functions through others who in fact simply act as their agents.

This emphasis upon closing the doors of a company to outsiders so far as stock ownership is concerned, and upon the direct, almost day to day management of the business by the shareholders, resembles a partnership rather than the common law concept of a corporation. Yet, at the same time, the shareholders of the close corporation highly prize the corporate privilege of limited liability, and to an almost surprising degree they have achieved this goal, even in the case of the one man corpora-

tion, despite some rather vague limitations on limited liability here not yet fully developed.

When, as often happens, the close corporation is not a one man or one family business but is owned or controlled by two or three individuals or family groups, problems are multiplied and more complicated. Restrictions on the transferability of the shares, the allocation of voting rights, provisions for dividends, assignments of directorships and officerships in the business—all must be carefully planned and worked out beforehand, and thereafter these must be so fixed that they cannot be changed to the detriment of any shareholder without his consent. Failure to give each shareholder such a veto power may well result in the well-known squeeze play or freeze out of one or more minority dissenting shareholders. Since the courts thus far have generally shown little imagination or ingenuity in protecting minority interests in this situation, the burden falls upon shareholders and their counsel to work out adequate protective provisions. Whether the Securities and Exchange Act may offer greater relief than the courts formerly have, is still uncertain.

On the other hand, preservation of the status quo through giving each shareholder a veto power, so that changes may not be made unless all the shareholders consent, may result in a complete deadlock so that action cannot be taken. In the event of such a corporate paralysis dissolution may be as necessary as if a partnership were involved. Yet all too frequently there is no statutory or judicial relief available. Here again, it is the responsibility of counsel to make certain that the corporate documents provide adequate machinery so far as possible for handling such deadlocks through provisions either for arbitration or for dissolution of the corporation.

One of the most striking facts about the close corporation is the extent to which it is the creation of business men and their counsel rather than of the courts or the legislatures. Most corporate legislation is admittedly drafted for the publicly owned company, at least in this country. Unlike Great Britain and Continental Europe, we have made little attempt in our corporate statutes to provide for the problems and the needs of the close corporation. Our tax laws, for example, treat practically all corporations alike, with only a few special provisions attempting to cope with the unique tax problems presented by the close corporation. The courts, by and large, have shown little more creative ability than the legislatures in this area, and only infrequently appear to appreciate the position of the close corporation. The result is that business men and their counsel, whose legitimate needs find expression and satisfaction in the close corporation, are often compelled to operate in clouds of legal doubts and uncertainties and with realities masked by corporate fictions necessitated by awkward legislation and judicial decisions. Consequently, although the close corporation is generally a smaller enterprise than its publicly owned counterpart, its corporate structure and papers as reflected, for example, in charter, by-laws, voting trusts, or stockholder agreements, are frequently far more complex and verbose. Perhaps the time is approaching when our corporate laws should be revised to correspond more closely with the needs and realities of the close corporation.

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