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CLOSE CORPORATIONS AND THE NEW YORK BUSINESS CORPORATION LAW OF 1961

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In the main, corporation statutes in our American jurisdictions have contained regulatory provisions applicable to all corporations without regard to the size of their membership. Then, as a result of centuries of judicial opinions, starting in England, corporation statutes have been interpreted as establishing norms that must be applied without variation to all corporations irrespective of the size of the shareholding body. It is submitted that all of this judge-made law has sprung from the unrealistic conception that there are two kinds of legal persons: the natural and the artificial corporate person. It has been inferred that the artificial corporate person has no capacity to act except as prescribed by statute, that is, (a) that it has no capacity to act beyond the powers conferred upon it by law or the purposes stated in its certificate of incorporation; (b) that management of the corporate business is vested exclusively in the board of directors, and that the proportionate vote of shareholders and directors required by statute for valid corporate action is not subject to variation by shareholder agreement.

Even though this is an unrealistic starting premise, the deductions are usually appropriate as applied to corporations with large membership. However, some of these deductions can also be rationalized with a premise that is realistic. One of the disadvantages of partnership law is that each partner has the power, as agent, to bind the firm. One of the advantages of corporation law is that the power of management of the business is, by statute and, therefore, by agreement between the shareholders, concentrated in the board of directors. The board is to exercise its authority in the interests of all shareholders, the minority as well as the majority, and its action is not to be reversed or controlled by the majority, except as the latter have the power to elect directors. Other provisions are included in the statutes for the protection of shareholders, such as those with regard to cumulative voting, voting by classes of shares and those with regard to preemptive rights. It is also a part of the shareholder agreement that the corporate capital shall be risked only in the business purposes stipulated in the certificate of incorporation, and, therefore, a minority can enjoin threatened ultra vires action.

But the formalistic ritual of the fictionist does not always coincide with the realities of life in a close corporation. Perhaps the chief difference between the publicly held and the close corporation is that in the former there is a separation between ownership and control which in itself requires some statu-

tory regulation. In the close corporation, however, ownership and control are identical, or it is the desire of the membership that they should be. The close corporation is in reality a partnership with the added benefit of limited liability, and it is managed and conducted informally as a partnership, and, usually, harmlessly so from any standpoint of public policy or interest. Its members are not indifferent proxy-signers. They may want an active voice in management, action by unanimous vote, or at least a veto on corporate action. They may want permanency in office, protection as to salaries, representation on the board of directors, perhaps by classes of shares, restrictions on the transferability of shares, or even the possibility of a ready and easy procedure for dissolution, as in the case of partnerships.

A statutory provision should be interpreted and applied in the light of the purpose or the interest it was designed to serve. But conceptions as to the legislative purpose and intent may differ. Thus, in the Benintendi case, the three shareholders, each owning one third of the shares, amended the by-laws to provide that action by the shareholders could be taken only by unanimous vote of the shareholders and action by the directors could be taken only by unanimous vote of the shareholders and action by the directors could be taken only by unanimous vote of the directors. These amendments were found to be intrinsically unlawful because they contravened an essential part of the state policy as expressed in the Stock Corporation Law, that is, the proportion of votes required by the statute for action by the shareholders or directors. "The State, granting to individuals the privilege of limiting their individual liabilities for business debts by forming themselves into an entity separate and distinct from the persons who own it, demands in turn that the entity take a prescribed form and conduct itself, procedurally, according to fixed rules." No differentiation could be made between a publicly held and a close corporation. As is well known, the legislature was prompted to express its intention otherwise in Stock Corporation Law, Section 9. On the other hand, the purpose of Stock Corporation Law, Section 16, requiring a mortgage to be approved by the holders of two thirds of the shares, given in writing or by vote at a shareholders' meeting, is to protect the shareholders against improvident, collusive or other unwise acts of the directors; and that purpose was held to have been fulfilled and the mortgage to be valid when unanimously approved by all the directors who held more than two thirds of the shares, even though there was not strict compliance with the section requiring approval in writing or by vote at a meeting of shareholders as such. The procedure there followed can occur in a small corporation but would be unlikely to happen in a corporation of large membership.

2. Id. at 118, 60 N.E.2d at 831, 159 A.L.R. at 283.
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It has been suggested from time to time that there should be a separate law adapted to the problems peculiar to close corporations. The difficulty has been to find a formula which adequately draws the line between the “small,” “close” or “family” corporation and the “large” or “quasi-public” corporation. The Joint Legislative Committee decided that it would be more practicable to have one Business Corporation Law and to inject into it some special provisions applicable to and usable by close corporations. As will be noted later, resort was had to a backhanded way of making some of these provisions applicable only to “close” corporations. First, the provision will not apply to a corporation the shares of which are traded on a national securities exchange. That is only a partial exclusion; it will not exclude unlisted corporations which may, nevertheless, have a large membership. Second, the provision can be inserted in the certificate of incorporation only if that is done with the unanimous approval of the holders of all the shares. If the membership is large, such unanimous approval is not likely to be obtainable.  

PROVISIONS RELATING TO CLOSE CORPORATIONS

Incorporation and Organization

Section 401, though it can apply generally to the formation of a corporation of any size, may be of special interest when it is planned to incorporate the business of an individual or of a partnership. That section provides that “one or more natural persons of the age of twenty-one years or over may act as incorporators of a corporation to be formed under this chapter.” Thus it will be possible for one or two persons to incorporate themselves. Furthermore, the existing qualifications as to residence, citizenship and subscription for shares have been eliminated. It will no longer be necessary to incorporate through “dummies” who meet the requirements of the present law as to the number and the qualifications of incorporators.  

Under Section 404, after the certificate of incorporation has been filed by the Department of State and the corporate existence has begun, an organization meeting is to be held, either within or without the state, for the election of directors to hold office until the first annual meeting, the adoption of by-laws and the transaction of such other business as may come before the meeting. Since it is provided that any action permitted to be taken at the organization meeting may be taken without a meeting if each incorporator or his attorney-in-fact signs an instrument setting forth the action so taken,


the organization of a corporation formed by one, or even more than one incorporator is rendered very simple.

The Court of Appeals has held that the law permits the incorporation of a business for the very purpose of escaping personal liability, provided that it is not accompanied by fraud, misrepresentation or illegality.6 One significant instance of a denial of immunity from personal liability is where there has been provided an obvious inadequacy of capital, measured by the nature and magnitude of the corporate undertaking.7

**Management Structure**

It is not required in Section 402 that the number of directors shall be set forth in the certificate of incorporation or that the names of the first directors be stated therein. Instead, it is provided in Section 702 that the number of directors may be fixed by the by-laws, or by action of the directors or shareholders under a by-law adopted by the shareholders. It would be normal, therefore, for the number to be fixed originally in the by-laws adopted by the incorporators at the organization meeting and for that number to be then elected.

There is no statutory restriction that directors have to be shareholders or that any proportion of them have to be citizens or residents of the state. These or other qualifications may be prescribed in the certificate of incorporation or the by-laws. However, it is required that the number of directors constituting the entire board shall not be less than three. This may be criticized as inconsistent with the authorization of a single incorporator. There may be one shareholder, but there must be three directors. Some relief from this abnormality may be found under Section 707, which, though providing that a majority of the entire board of directors shall constitute a quorum, still permits the certificate of incorporation or the by-laws to fix a quorum at less than a majority but not less than one third thereof, which could be one. So, with a board of three directors, the one who incorporated himself can constitute himself a quorum for the transaction of corporate business. It is being recommended that the 1962 Legislature adopt the recent amendment to the Delaware law, effective in the summer of 1961, providing that when all the shares of a corporation are owned beneficially and of record by either one

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or two shareholders, the number of directors may be less than three but not less than the number of shareholders.\(^8\)

If it is desired that each shareholder or faction of shareholders shall have representation on the board of directors, advantage can be taken of Sections 501 and 703, under which the certificate of incorporation can provide for the division of shares into classes and for the election of one or more directors by the holders of shares of each class, voting as a class.

Classification of shares may be used also to effect a reverse situation, namely, to concentrate in one faction the right to elect directors. This can be done by classifying into voting and non-voting shares and issuing the voting shares to the group intended to have this control over the election. It should be noted that though, under Section 501, the certificate of incorporation may deny, limit or otherwise define the voting rights of shares of any class, there is, in Section 613, the qualification "except as otherwise provided in this chapter." Section 804 reads that notwithstanding any provision in the certificate of incorporation to the contrary, the holders of shares of a class shall be entitled to vote and to vote as a class upon any amendment that would adversely affect or subordinate the rights of the holders of the shares of that class. A similar provision is found in Section 903 in the event that a proposed merger or consolidation would have like effect upon the rights of the holders of a class of shares. Sections 620 and 1105\(^9\) require the consent of all shareholders, non-voting as well as voting, to include in the certificate of incorporation a provision as to the control of directors or an agreement for dissolution. On the other hand, a limitation on voting rights confined to a denial of the right to vote in the election of directors will have a more extensive effect, for, in a few sections of the act, the right to vote on particular matters is given to those "entitled to vote in the election of directors." This is so with regard to voting upon by-laws, Section 601, and upon dissolution in the event of a deadlock, Section 1104.

When the shareholding interests are not equal, consideration can be given to the possible effectiveness of having the certificate of incorporation require cumulative voting under Section 618. An alternative would be to resort to Sections 616 and 709, which contain the substance of Stock Corporation Law, Section 9 and permit the certificate of incorporation to require a greater quorum at shareholders' and directors' meetings and a greater vote in each case than would otherwise be prescribed by law. It is to be noted that such a requirement would not be valid if contained in the by-laws,\(^10\) and that notice of the existence of such a provision must appear on the share certificates issued by the corporation.

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9. See infra note 34 as to change of section number.

Solidity of voting can be obtained through a voting trust agreement under Section 621, without provision having to be made therefor in the certificate of incorporation.

Significant contributions to the law of New York are contained in Section 620. Though paragraph (a) is not exclusively applicable to close corporations, it can be especially useful in the conduct of a business enterprise of that type. It provides:

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

An agreement between shareholders to vote their shares "as they may agree" is, as was said in Helms v. Duckworth, like the statutory obligation of employers and unions to bargain in good faith. In that case, there was an agreement that the survivor of the only two shareholders should have an option to buy the shares of the deceased shareholder at $10 or at a price to be agreed on in January of any year. Seven years later one of the parties died when, concededly, each share was worth $80. The other party tendered the administratrix his check at the rate of $10 a share and demanded delivery of the shares. Neither party had ever proposed a change in the price. The administratrix brought an action for the cancellation of the agreement. An affidavit of the defendant stated that it was never his intention at any time to consent to any change in the price. It was held that his failure to disclose this fixed intent to his corporate business "partner" was a flagrant breach of a fiduciary duty. "We believe that the holders of closely held stock in a corporation such as shown here bear a duty to deal fairly, honestly and openly with their fellow stockholders and make disclosure of all essential information." This conception of the fiduciary relation between the shareholders in a close corporation merits wider recognition and enforcement.

That it is legal for some or all shareholders to agree to vote alike in the election of directors was established by the dictum in Manson v. Curtis and the decision in Clark v. Dodge. Paragraph (a) of Section 620 will sanction agreements for pooling votes on some or all matters for shareholder decision as well as in the election of directors. Standing alone such an agreement would not be self-executing and a threatened breach by some of the parties might precipitate litigation. The result might be similar even if the parties adopted

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the suggestion in this paragraph of agreeing to vote “in accordance with a procedure agreed upon by them,” for example, to vote as directed by an umpire selected by them.\textsuperscript{15} However, Section 609 anticipates another possibility which could make the agreement self-executing, that is, that the parties give an irrevocable proxy to one person to vote in their behalf. Section 609 is a restatement of Stock Corporation Law, Section 47-a with this amendment added. On the other hand, an advance agreement upon some procedure for a reconciliation of differences, which would become effective only if and when the parties find themselves unable to agree, may be found more desirable than an advance commitment to the decision of one who has been given an irrevocable proxy.

It is often the desire, and even the practice, of the members of an “incorporated partnership” to conduct the business with the informality of a partnership while enjoying other advantages of incorporation. Sometimes, they may see no utility or necessity in holding formal meetings. Section 615 contains a general authorization that any action that may be taken by vote of the shareholders may be taken without a meeting on the written consent of the holders of all shares entitled to vote thereon.

They may wish to dispense with the formality of action by the board of directors or even to deprive the directors of some of the functions of management of the business. The substance of General Corporation Law, Section 13(2), that the certificate of incorporation may contain any provision for the regulation of its business and the conduct of its affairs and any limitation upon the powers of its directors, has been carried into Sections 402 and 601, but the qualification in Section 13 that the limitation upon the powers of the directors must not exempt them from the performance of any obligation or duty imposed by law, coupled with the orthodox view that the power of management of the corporate business is vested exclusively in the board of directors, has created considerable doubt as to the validity of any such limitations contained in the certificate of incorporation.

With respect to an agreement between some, but not all, shareholders to use their best efforts to keep each other in office as directors and as officers and to make no change in salaries or policy without consent of all the parties, it was held that “The power to unite . . . is limited to the election of directors and is not extended to contracts whereby limitations are placed on the power of the directors to manage the business of the corporation by the selection of agents at defined salaries.”\textsuperscript{16}

\textsuperscript{15} In Ringling Bros.-Barnum & Bailey Combined Shows, Inc. v. Ringling, 29 Del. Ch. 610, 55 A.2d 441 (Sup. Ct. 1947), noted in 36 Calif. L. Rev. 281 (1948), 50 Harv. L. Rev. 651 (1947), 46 Mich. L. Rev. 70 (1947), 15 U. Chi. L. Rev. 738 (1948), 96 U. Pa. L. Rev. 121 (1947), two of three shareholders agreed to abide by the decision of a designated arbitrator. When one of the parties voted contrary to the arbitrator’s decision, it was held that her votes, cast in breach of her agreement, should not be counted.

\textsuperscript{16} McQuade v. Stoneham, 263 N.Y. 323, 329, 189 N.E. 234, 236 (1934).
A similar agreement between a majority, but not all, of the shareholders provided that the plaintiff was to manage the corporate business and shape and control corporate policy and that the president was to be only a nominal and non-interfering head of the corporation. The Court of Appeals held that the intent to have a passive president included the intent to have passive directors and that this violated the statutory provision which vested management of corporate affairs in a board of directors. "Clearly the law does not permit the stockholders to create a sterilized board of directors."  

In Clarke v. Dodge, the agreement was assented to by all the shareholders and provided (a) that Dodge, as a shareholder, would vote for Clark as a director, (b) as a director, he would continue Clark as general manager, so long as he proved faithful, efficient and competent, and (c) that Clark should always receive as salary or dividends one fourth of the net income. It is to be noted that the board retained authority to remove Clark for incompetence and some discretion in determining what was "net income." The Court said:

If the enforcement of a particular contract damages nobody—not even, in any perceptible degree, the public—one sees no reason for holding it illegal, even though it impinges slightly upon the broad provision of section 27. . . . Where the directors are the sole stockholders, there seems to be no objection to enforcing an agreement among them to vote for certain people as officers. . . . If there was any invasion of the powers of the directorate under that agreement, it is so slight as to be negligible; and certainly there is no damage suffered by or threatened to anybody.

Another agreement between the holders of all the shares of a New Jersey corporation vested the management of the theatre business of that corporation in a New York corporation for a period of nineteen years unless the management should be changed as a result of arbitration. The parties stipulated that because the agreement was made in New York, its validity should be determined by the law of New York. It was held that the restriction here, depriving the directors of the power to select or change the manager, went far beyond the agreement in Clark v. Dodge and was invalid under Section 27 of the New York General Corporation Law. But one may ask, "Why, if that was the arrangement agreed upon by the holders of all the shares?"

19. Clark v. Dodge, id. at 415, 199 N.E. at 642.
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The above decisions were interpretations of what was assumed to be the legislative intention. From that standpoint, there are sections in the Business Corporation Law that will have a bearing upon those decisions and indicate a different legislative intention.

As already indicated, the certificate of incorporation may require that the proportion needed for a quorum or vote of directors shall be greater than that specified in the act (Section 709).

Section 706 provides that if the certificate of incorporation or by-laws so provide, any or all of the directors may be removed without cause by vote of the shareholders, but protection is given against any such removal that would be inconsistent with any existing right to vote cumulatively or by classes of shares.

Paragraph (d) of Section 706 provides that an action to procure a judgment for the removal of a director for cause may be brought by the Attorney General or by the holders of ten per cent of the outstanding shares, whether or not entitled to vote, and that the court may bar from reelection any director so removed for a period fixed by the court. It will be recalled that Section 61 of the General Corporation Law provides that a proceeding for removal of a director for cause may be brought only by the Attorney General. It will be recalled also that the common law right to remove for cause by vote of the shareholders may become impracticable if the certificate of incorporation contains a Section 9 provision.

Under Section 715(b), the certificate of incorporation may provide that all officers, or that specified officers, shall be elected by the shareholders instead of by the board, and under Section 717, an officer elected by the shareholders may be removed, with or without cause, only by a vote of the shareholders.

Perhaps the most far-reaching provision contained in the new Law for enabling members of a close corporation to modify the normal incidents of corporateness is found in paragraph (b) of Section 620. This reads:

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1 Hornstein, id. at § 171, reminds us that originally in England management was in the hands of the shareholders and they were the source of the directors' powers, and that from 1929 to 1947, the English statute did not require a board of directors in a "private company." See Kessler, The Statutory Requirement of a Board of Directors: A Corporate Anachronism, 27 U. Chi. L. Rev. 696, 713 (1960).

(b) A provision in the certificate of incorporation otherwise prohibited by law as improperly restrictive of the discretion or powers of the directors in their management of corporate affairs as provided in this chapter shall nevertheless be valid: . . .

"Otherwise prohibited by law as restrictive of the discretion or powers of the directors" is in contrast with the wording of General Corporation Law Section 13(2) which does not permit any limitation that would "exempt them [directors] from the performance of any obligation of duty imposed by law."

In addition, Section 701, which states that the business of a corporation shall be managed by its board of directors, carries this important qualification, "subject to any provision in the certificate of incorporation authorized by paragraph (b) of section 620," making clear the legislative intention that a provision in the certificate of incorporation can control the discretion and powers of the directors. In this respect, the two provisions permit going beyond the decision in Clark v. Dodge where the limitation was a slight impingement on the provision in Section 37 of the General Corporation Law. A limitation authorized by Section 620(b) is recognized in Section 701 as a permissible limitation upon the authority of the board of directors to manage the business of the corporation.22

The wording of Section 701, "Subject to any provision in the certificate of incorporation authorized by paragraph (b) of section 620 [title of section], the business of a corporation shall be managed by its board of directors . . . ," is susceptible of alternative interpretations: (1) that the certificate might provide that the business shall be managed otherwise than by a board of directors, or (2) that there must be a board of directors but Section 620(b) permits the creation of a sterilized board. In either case, it is provided in paragraph (e) of Section 620 that the effect of any provision authorized by paragraph (b) shall be to relieve the directors and impose upon the shareholders consenting

22. Section 620 is commented upon in 75 Harv. L. Rev. 852 (1962). See also, Hoffman, op. cit. supra note 4 at 5 and Kessler, op. cit. supra note 4 at 44. Section 620(b) is a revised version of N.C. Gen. Stat., § 55-73(b) (Supp. 1959):

Except in cases where the shares of the corporation are at the time or subsequently become generally traded in the markets maintained by securities dealers or brokers, no written agreement to which all of the shareholders have actually assented, whether embodied in the charter or by-laws or any side agreement in writing and signed by all the parties thereto, and which relates to any phase of the affairs of the corporation, whether to the management of its business or division of its profits or otherwise, shall be invalid as between the parties thereto, on the ground that it is an attempt by the parties thereto to treat the corporation as if it were a partnership or to arrange their relationships in a manner that would be appropriate only between partners. Notwithstanding any other provision of this section or of this chapter, the provisions of G.S. 55-59(a) shall not apply to such agreement. A transferee of shares covered by such agreement who acquires them with knowledge thereof is bound by its provisions.

Section 55-24(a) reads:

Subject to the provisions of the charter, the by-laws or agreement between the shareholders otherwise lawful, the business and affairs of a corporation shall be managed by a board of directors.

thereto, the liability for managerial acts or omissions that is imposed on directors to the extent that and so long as the discretion and powers of the directors is controlled by any such provision.

There are limitations upon the use of Section 620(b). In the first place a provision authorized by it is valid only so long as the shares of the corporation are not traded on a national securities exchange or regularly traded in an over-the-counter market. Though this restriction does not exactly coincide with a definition of a close corporation, it does exclude most of the publicly held corporations. More important and exclusive is the requirement that a provision authorized by the section will not be valid unless authorized by the unanimous consent of the incorporators or the holders of all the shares, whether or not entitled to vote. Such unanimity of approval is not likely to be obtainable except in a close corporation.

In an effort to prevent surprise to one who might become a shareholder after such a restrictive provision had been adopted, it is required that such a provision must be contained in the certificate of incorporation and that notice of it must appear on every certificate for shares. It is also provided in subparagraph (b)(2) that an adopted provision continues to be valid only if a new shareholder consented to it in writing or had knowledge or notice of it.23

Dissolution

One of the hazards of conducting business as a close corporation is that the amicableness, agreement and trust of the associates at the optimistic outset of the venture may deteriorate into hostility, irreconcilable disagreement as to policy and management, positions and salaries and complete distrust. If the associates were partners, rather than shareholders, a termination of the association would be readily available through dissolution.

Among the causes for dissolution listed in the Uniform Partnership Law are: (1) Without violation of the partnership agreement, by the express will of any partner when no definite term or particular undertaking is specified or by the express will of all the partners; (2) In contravention of the partnership agreement, by the express will of any partner or by the death or bankruptcy of a partner, or by decree of court.24 Interpreting this section, the Court of Appeals has said: "No one can be forced to continue as partner against his will. He may be liable for breach of contract. Nothing more."25

23. This is the form in which it is being recommended for amendment in 1962.
25. Cahill v. Haff, 248 N.Y. 377, 382, 162 N.E. 288, 289 (1928). The partnership agreement provided that it could be terminated upon sixty days' written notice. The Court said: Notwithstanding this clause, however, either party might repudiate it any time. Then it ended. No agreement can prevent this result. No one can be forced to continue as partner against his will. He may be liable for breach of contract. Nothing more.

Courts have taken a different attitude toward the dissolution of corporations. Under Stock Corporation Law, Section 105, a certificate of voluntary dissolution may be authorized by the vote of the holders of two thirds of the shares entitled to vote thereon or upon the written consent of the holders of all such shares. Under Sections 101 and 102 of the General Corporation Law, a petition for dissolution may be presented if authorized by a majority of the directors or the holders of a majority of the shares entitled to vote on the question. If directors or shareholders are deadlocked, then Section 103 provides that unless otherwise provided in the certificate of incorporation, the vote of the holders of one half of the shares entitled to vote at an election of directors shall be sufficient and, if the certificate requires a greater vote of shareholders than that required by law, then the vote of the holders of one third of the shares shall be sufficient. Where the petition is approved by the shareholders, the court is given discretion by Section 106 to entertain or dismiss the application and, under Section 117, upon an application for a final order, the court must find: (1) that the case is one specified in Article 9, that is, in the case of a deadlock, that there is in fact a deadlock; (2) that a dissolution will be beneficial to the shareholders, and (3) that a dissolution will not be injurious to the public.

In the well-known case of In re Radom & Neidorff, Inc., two men had owned all the shares in equal proportions. Neidorff died and his widow, the sister of Radom, succeeded to his half interest. The brother and sister disliked and distrusted each other. In fact, she had brought a derivative suit charging him with enriching himself at the corporation’s expense and assigned this as a reason for her refusal to sign his salary check. Because of their unresolved difficulties, they had been unable to elect a third director at the annual meeting. Upon the basis of these facts, Radom presented a petition for dissolution. The Special Term entertained the petition and ordered a reference to determine the facts. The Appellate Division ordered that the petition be dismissed and the Court of Appeals, in a four to three decision, affirmed the Appellate Division. It is significant that the respondent, in her answering papers, alleged that Radom had offered her $75,000 for her shares, and, when she rejected this, he had threatened to have the corporation dissolved and to buy in the business or, if she should be the purchaser, to start a competing business. The majority of the Court concluded that, in spite of the feuding, there was no stalemate as

26. To the same effect are N.Y. Bus. Corp. Law §§ 1001, 615.
27. Like provisions are contained in N.Y. Bus. Corp. Law §§ 1102, 1103.
28. Section 1104 of the N.Y. Bus. Corp. Law has this provision in a modified form.
29. N.Y. Bus. Corp. Law, Section 1112 makes changes in this section. It should be noted that Section 1112 will become Section 1111 if the change mentioned in note 34, infra, is made.

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to corporate policies, that the corporate business was flourishing, making an average annual profit of about $71,000, and that Radom had no grievance cognizable by a court except as to the non-payment of his salary, which was not a ground for judicial dissolution. It was held that, since this was not a case for judicially-imposed death, there was no need for the order of reference.

New Jersey has a similar provision for dissolution by a court in the event of a deadlock and its Supreme Court held that it was proper to order dissolution when each of two factions of shareholders had the right to elect two of a board of four directors, when the board was so deadlocked as to corporate policies that it did not meet for several years with the result that management had been dictated by the holder of the majority of the common shares who happened to be the manager at the time that the deadlock occurred, and who had refused to pay dividends on the cumulative preferred shares. The court found that there was a want of that community of interest essential to corporate operation and that if the petition for dissolution were denied, there would be no alternative corrective remedy. Dissolution would be in the best interests of the shareholders, and also in the public interest because the statute required the business of a corporation to be managed by its board of directors.\textsuperscript{31}

An encouraging decision has been rendered by the Supreme Court, Erie County, in \textit{In re Pivot Punch & Die Corporation}.\textsuperscript{32} The petitioner and the respondent each owned one half of the shares. After three years of dissension as to management and policy, three arbitrators decided that the petitioner's employment by the corporation should terminate immediately. For the next three years, the petitioner had no voice in management. The directors were holding over because of an inability to elect new directors at the last two annual meetings. The respondent had been controlling the policy and had been receiving a substantial return for his services and upon his investment and the petitioner had been receiving nothing. Respondent contended that the petition should be denied because there was no deadlock of the directors who agreed with him that there should be no dissolution. But the court pointed out that the statute is in the alternative, a deadlock of directors or a deadlock of shareholders so that they cannot elect directors. The court emphasized that this was a close corporation, an incorporated partnership, and pointed out that, under partnership law, when loyalty and confidence between partners cease, the true partnership ceases. By analogy, when these characteristics no


\textsuperscript{32} 15 Misc. 2d 713, 182 N.Y.S.2d 459 (1959). Modified by directing that the hearing be before the court and not a referee. Affirmed as modified, 9 A.D.2d 861, 193 N.Y.S.2d 34 (4th Dep't 1959). Cf. Levine v. Styleart Press, Inc., 31 Misc. 2d 106, 217 N.Y.S.2d 688 (Sup. Ct. 1961), holders of two thirds of shares were in fiduciary relation to holder of one third and were enjoined from dissolving corporation for their individual advantage. Gaines v. Adler, — A.D.2d —, 223 N.Y.S.2d 1011 (1st Dep't 1962), upheld the complaint in a minority shareholders' action for dissolution alleging that the corporation was being exploited exclusively for the private benefit of its managing and controlling shareholders.
longer exist between the shareholders of a close corporation, the corporation ceases to be beneficial to the deadlocked shareholders. Distinguishing the Radom case, the court found that the petition alleged a stalemate, that the corporation was weak and declining and that dissolution was needed for the good of the shareholders and of the public. Accordingly, the court appointed a referee to determine the facts.

Changes which should be helpful in facilitating dissolution when the shareholders of a close corporation are in irreconcilable conflict have been included in the Business Corporation Law.

In the first place, it is provided in Section 1104(a)(6) that, notwithstanding any provision in the certificate of incorporation, any holder of shares entitled to vote in an election of directors may present a petition for dissolution on the ground that the shareholders are so divided that they have failed, for a period which includes at least two consecutive annual meeting dates, to elect directors.\(^3\)

In the second place, to specify that a deadlock among shareholders is a ground for dissolution only when they “are so divided that they cannot elect a board of directors” is too narrow. This is especially true in view of the provision in Section 620(b) permitting restrictions upon the discretion of powers of the directors. It is true also because the shareholders may be in conflict as to matters of corporate policy as well as in the election of directors, or they may no longer trust one another, or the conduct of one may be prejudicial or harmful to the others. Under any of such circumstances, dissolution would be beneficial to the shareholders and there certainly can be no public interest in compelling the continuance of an unworkable association. In addition to stating, as a ground for dissolution, that the shareholders are so divided that the votes required for the election of directors cannot be obtained, Section 1104 lists as a further ground that there is internal dissension and two or more factions of shareholders are so divided that dissolution would be beneficial to the shareholders. It is further provided in Section 1112 that, as criteria for the court’s decision, (1) public interest is of paramount importance when the action for dissolution is brought by the Attorney General; (2) benefit to the shareholders is of paramount importance when the proceeding is brought by the directors of shareholders; and (3) in a proceeding brought because of deadlock or dissension, dissolution is not to be denied merely because it is found that the corporate business has been or could be conducted at a profit.\(^4\)

Because experience has shown that dissension and distrust can overtake

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34. In the Law as passed in 1961, this appears as Section 1112, but it is being considered that Section 1105 should be transferred from Article 11 on Judicial Dissolution to Article 10, Non-Judicial Dissolution, as Section 1002. If this change is made Section 1112 will become Section 1111. The minority opinion in In re Radom & Neidorff, Inc., supra note 30, pointed out that the sole issue under N.Y. Gen. Corp. Law, Section 103 is whether there is a deadlock, not whether the business is being conducted at a profit or loss.
an originally harmonious family or other group of associates, that contingency should be guarded against at the outset of a corporate venture. A deadlock is particularly apt to occur when provision is made for unanimous, or almost unanimous, vote of directors and shareholders. The Business Corporation Law has a new provision permitting the certificate of incorporation to contain, if approved by the holders of all shares, whether or not entitled to vote thereon, a provision that any shareholder, or the holders of any specified number or proportion of shares may enforce dissolution, at will or upon the occurrence of any specified event. This provision could be used to supplant the other statutory provisions for dissolution by vote of the shareholders and to have the possibility of dissolution as readily available as under the Partnership Law and without judicial proceedings. The inclusion of this provision in the statute will remove any doubt as to the validity of such an agreement that might arise under the principle enunciated in the *Benintendi* decision. Because of the importance of an agreement authorized by this section, it must have received unanimous approval, and it must be contained in the certificate of incorporation which is to be filed of record and reference to it must be stated on each certificate for shares.

**SUMMARY**

Upon the recommendation of the Joint Legislative Committee to Study Revision of the Corporation Laws, there have been included in the new Business Corporation Law, authorizing and regulating both large and small corporations, the various provisions highlighted in the above discussion with the purpose of adapting New York statute law to some of the more pressing problems and needs of the close corporation. In adopting the Committee's recommendations, the Legislature has recognized the distinctions between the publicly held and the close corporations as they exist in day-to-day operation and has explicitly expressed a legislative intention that the two types of corporations should be treated differently. It should follow that the specific provisions referred to should not be regarded as exclusive instances, but as examples for that different treatment, and that the Law, in all its parts, should be interpreted to give effect to that legislative purpose and intention.

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