CLOSE CORPORATION LAW: MICHIGAN, DELAWARE AND THE MODEL ACT

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I. INTRODUCTION

The term "close corporation" has been defined in a variety of ways by various commentators and authorities. One popular definition states that a "close corporation is a corporation whose shares are not generally traded in the securities market."[1] Close corporations play a vital role in the American economy because the majority of business corporations retain closely-held status.[2] Given their impor-

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M. Scott Wilson for their valuable research assistance. I also wish to thank Charles W. Borgsdorf and Paul A. Ward, both of whom practice corporation law in Michigan, for their review of the manuscript and suggestions. This research was supported by a grant from the Independent Business Research Office of Michigan.

1. F. O'NEAL, CLOSE CORPORATIONS § 1.02 (2d ed. 1971) [hereinafter cited as F. O'NEAL]. For the purposes of discussing the Michigan Act, this relatively simple and broad definition will suffice. The Model Statutory Close Corporation Supplement's definition which appears below is more complex and will be discussed in detail, *infra* notes 136-138 and accompanying text.

§ 3. DEFINITION AND ELECTION OF STATUTORY CLOSE CORPORATION STATUS.

(a) A statutory close corporation is a corporation whose articles of incorporation contain a statement that the corporation is a statutory close corporation.

(b) A corporation having 50 or fewer shareholders may become a statutory close corporation by amending its articles of incorporation to include the statement required by subsection (a). The amendment must be approved by the holders of at least two-thirds of the votes of each class or series of shares of the corporation, voting as separate voting groups, whether or not otherwise entitled to vote on amendments. If the amendment is adopted, a shareholder who voted against the amendment is entitled to assert dissenters' rights under [MBCA ch. 13].

§ 10. NOTICE OF STATUTORY CLOSE CORPORATION STATUS ON ISSUED SHARES

(a) The following statement must appear conspicuously on each share certificate issued by a statutory close corporation:

The rights of shareholders in a statutory close corporation may differ materially from the rights of shareholders in other corporations. Copies of the articles of incorporation and bylaws, shareholders' agreements, and other documents, any of which may restrict transfers and affect voting and other rights, may be obtained by a shareholder on written request to the corporation.

Model Stat. Close Corp. Supp. §§ 3, 10(a) (1984).

2. H. HENN & J. ALEXANDER, LAWS OF CORPORATIONS AND OTHER BUSINESS

tance, state laws should be designed to recognize and accommodate the special needs of close corporations, thus serving to promote, rather than impede, business growth. This is often a difficult goal because a close corporation combines certain characteristics of both the partnership and the publicly-held corporation. Shareholders in a close corporation, like general partners, need flexibility in order to meet their particular business and personal needs. Shareholders may, for example, operate their business under a shareholders' agreement which is similar to a partnership agreement.[3] They also may restrict the transferability of shares[4] and, in certain circumstances, elect to be taxed like a partnership.[5] However, as in a public corporation, the liability of shareholders in a close corporation is limited to their investment in the business.[6]

ENTERPRISES § 257 (1983) [hereinafter cited as H. HENN. & J. ALEXANDER]. Most close corporations are relatively small, however, there are exceptions. In the manufacturing industry, The Stroh Brewery, Steelcase, and Hallmark Cards are examples of close corporations. Whereas in the service sector Domino's Pizza and Bechtel are two such representatives.

3. An example of a shareholder agreement similar to a partnership appears in the Model Close Statutory Corporation Supplement which provides in relevant part:

> (a) All the shareholders of a statutory close corporation may agree in writing to regulate the exercise of the corporate powers and the management of the business and affairs of the corporation or the relationship among the shareholders of the corporation.
> (b) An agreement authorized by this section is effective although:
> . . . .
> (3) its effect is to treat the corporation as a partnership; or
> (4) it creates a relationship among the shareholders or between the shareholders and the corporation that would otherwise be appropriate only among partners.

4. Model Stat. Close Corp. Supp. § 11 provides in relevant part: "(a) An interest in shares of a statutory close corporation may not be voluntarily or involuntarily transferred, by operation of law or otherwise, except to the extent permitted by the articles of incorporation or under section 12."

5. Federal and state tax statutes in general treat corporations, whether publicly-held or close, as independent tax entities. *See* F. O'NEAL, *supra* note 1, § 8.17. This characterization often results in double taxation of corporate income. For instance, corporate income is subject to a tax and the same income, if available, may be subject to a second tax whenever it is distributed to individuals as dividends. *Id.* A close corporation that meets designated requirements may escape this double taxable if it qualifies for treatment by the IRS. If a corporation elects S corporation status, its income is taxed through its shareholders and, therefore, not taxed at the corporate level. *Id.* This special treatment applies to federal taxation, however, most state tax statutes do not provide for such special treatment option. *Id.*

6. The Model Statutory Close Corporation Supplement provides: "The failure of a statutory close corporation to observe the usual corporate formalities or requirements relating to the exercise of its corporate powers or management of its

In dealing with the unique features of a close corporation, state corporation laws appear in two distinct formats. Some states have what are called "integrated statutes," where the close corporation provisions are found in a separate chapter within the business corporation statute.[7] The Delaware integrated close corporation law, considered to be "especially accommodating"[8] to shareholders of close corporations, has served as a model for several other states.[9] The Model Statutory Close Corporation Supplement (Supplement)[10] developed by an American Bar Association (ABA) Committee also uses the integrated format. Most states, however, do not use the integrated approach; instead close corporation provisions are spread throughout their general corporation statutes.[11] The Michigan general corporate law statute is exemplary of the non-integrated approach.[12]

The purpose of this paper is to compare the Supplement with close corporation law in Delaware and Michigan. After an overview of the close corporation law of these two states (in the following section), we will turn to a comparison of these laws with the Supplement. This article concludes with an evaluation of the three laws on the basis of several broad principles especially important in close corporation law.

II. BACKGROUND: THE STATUTES

This section provides an overview of close corporation law in Michigan and Delaware. The Michigan law will be covered in greater

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business and affairs is not a ground for imposing personal liability on the shareholders for liabilities of the corporation." Model Stat. Close Corp. Supp. § 25.

7. *See, e.g.*, ALA. CODE §§ 10-2A-300 to -313 (1985); ARIZ. REV. STAT. ANN. §§ 10-201 to -218 (1986); CAL. CORP. CODE § 158 (West 1986); DEL. CODE ANN. tit. 8, §§ 341-356 (1984); ILL. ANN. STAT. ch. 32, §§ 1201-1216 (Smith-Hurd 1985); KAN. STAT. ANN. §§ 17-7201 to -7216 (1981); ME. REV. STAT. ANN. tit. 13A, § 102(5) (1981); MD. CORPS. & ASS'NS CODE ANN. §§ 4-101 to -603 (1984); OHIO REV. CODE ANN. § 1701.591 (Page 1985); PA. STAT. ANN. tit. 15, §§ 1371-1386 (Purdon 1985); R.I. GEN. LAWS § 7.1.1 to 7.1.51 (1985); TEX. BUS. CORP. ACT ANN. arts. 12.01-.54 (Vernon 1986).

8. H. HENN & J. ALEXANDER, *supra* note 2, at 178.

9. *See* Model Stat. Close Corp. Supp. § 55 (special comment—statutory comparison) which provides: "Most integrated state close corporation statutes were modeled on the Delaware provisions (Illinois, Kansas, Pennsylvania, and to a lesser extent, Texas). The other states, particularly Arizona and Maryland, have distinctive statutes with a number of innovative features."

10. Model Stat. Close Corp. Supp. §§ 1-55.

11. *Id.* § 55. *See supra* note 7 (examples of states which have integrated statutes).

12. MICH. COMP. LAWS § 450.1103 (West 1973) (MICH. STAT. ANN. § 21.200(103)(c) (Callaghan 1983)).

detail because the close corporation provisions are not contained within a separate chapter of the Business Corporation Act and thus are more difficult to locate and summarize.[13]

A. The Michigan Statute

In adopting the Michigan Business Corporation Act (the Act), the Michigan legislature not only recognized the popularity of conducting business as a small corporation, but also the unique problems which stem from operating in a close corporation capacity.[14] The Act provides for liberal construction and includes as one of its underlying purposes the granting of "special recognition to the legitimate needs of close corporations."[15] Most of the close corporation provisions pertain to all corporations, but smaller corporations with limited shareholders are particularly affected.

1. Corporate Formation

The procedure for establishing a corporation under the Act is not complicated. Under the Michigan statute's definition of "person," such business organizations as partnerships, corporations, as well as individuals,[16] may create a corporation by executing and filing

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13. *See supra* note 11 and accompanying text.

14. *See* Darwin v. Belmont Indus., Inc., 40 Mich. App. 672, 199 N.W.2d 542 (1972). Special problems exist, for example, for the close corporation in the context of a freezeout situations.

The Illinois Supreme Court, in Galler v. Galler, 32 Ill. 2d 16, 203 N.E.2d 577 (1964), recognized the special character of the close corporation stating:

> While the shareholder of a public-issue corporation may readily sell his shares on the open market should management fail to use, in his opinion, sound business judgment, his counterpart of the close corporation often has a large total of his entire capital invested in the business and has no ready market for his shares should he desire to sell. He feels, understandably, that he is more than a mere investor and that his voice should be heard concerning all corporate activity.

Id. at 27, 203 N.E.2d at 583-84. Because of pressure during a freeze out, the following losses may be incurred by a minority shareholder: (1) complete divesture of any control in the corporation; (2) deprivation of information affecting corporate affairs and decisions; (3) unemployment; (4) abrupt devaluation of his investment as a result of cessation of dividends or salary; and (5) inability to take his money out of the business or borrow using his interest as security. O'Neal & Modeling, *Problems of Minority Shareholders in Michigan Close Corporations*, 14 WAYNE L. REV. 723, 731-32 (1968).

15. MICH. COMP. LAWS § 450.1103 (MICH. STAT. ANN. § 21.200(103)(c)).

16. *Id.* § 450.1108(2) (MICH. STAT. ANN. 21.200(108(2)) ("Person" means an individual, a partnership, a domestic or foreign corporation, or any other association, corporation, trust, or legal entity.). The attorney general, observing

the articles of incorporation.[17] One person may incorporate[18] and the articles need contain only a minimal number of mandatory provisions.[19] Optional provisions are also permitted, provided they are consistent with the Act and other state laws governing the manage-

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that neither the Business Corporation Act nor the General Corporation Act provide for qualifications of incorporators, has opined that minors may not act as an incorporator, director, or officer of a profit or nonprofit Michigan corporation. Mich. Att'y Gen. Op. No. 5893 (May 8, 1981). The attorney general relied on common law to determine the ability of a minor to act as incorporator, officer, or director. The common law rule is that incorporators must have the ability to contract. 1 W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 83 (rev. perm. ed. 1974). Minors, lacking the ability to contract, may not, therefore, act as incorporators or managers of corporations. *See* Pollock, *Business Associations*, 28 WAYNE L. REV. 553, 575 (1982).

17. MICH. COMP. LAWS § 450.1201 (MICH. STAT. ANN. § 21.200(201)) (requiring only a single copy be filed).

18. *Id.* § 450.1201 (MICH. STAT. ANN. § 21.200(201)).

19. *Id.* § 450.1202 (MICH. STAT. ANN. § 21.200(202)).

The articles of incorporation shall contain:

(a) The name of the corporation.

(b) The purposes for which the corporation is organized. It is a sufficient compliance with this subdivision to state substantially, alone or with specifically enumerated purposes, that the corporation may engage in any activity within the purposes for which corporations may be organized under the business corporation act, and all such activities shall by such statement be deemed within the purposes of the corporation, subject to expressed limitations, if any: Provided, however, That any corporation which proposes to conduct educational purposes shall state such purposes and shall comply with all requirements of sections 450.170 to 450.177 of the Compiled Laws of 1948.

(c) The aggregate number of shares which the corporation has authority to issue; the number and par value of any shares having a par value; and the number of any shares without par value together with a statement that such shares are without par value.

(d) If the shares are, or are to be, divided into classes, or into classes and series, the designation of each class and series, the number of shares in each class and series, and a statement of the relative rights, preferences and limitations of the shares of each class and series, to the extent that the designations, numbers, relative rights, preferences and limitations have been determined.

(e) If any class of shares is to be divided into series, a statement of any authority vested in the board to divide the class of shares into series, and to determine or change for any series its designation, number of shares, relative rights, preferences and limitations.

(f) The street address, and the mailing address if different from the street address, of the corporation's initial registered office and the name of the corporation's initial resident agent at that address.

(g) The names and addresses of the incorporators.

(h) The duration of the corporation if other than perpetual.

Id.

ment or powers of the corporation, directors, and shareholders.[20] Optional provisions often include variations in voting power such as supermajority[21] and class[22] voting requirements, control agreements,[23] share transfer restrictions,[24] authorization of action without a shareholder meeting[25] and preemptive rights.[26]

The bylaws,[27] in combination with shareholder voting and control agreements,[28] serve as a mechanism for adapting the corporate form

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20. *Id.* § 450.1209 (MICH. STAT. ANN. § 21.200(209)). This section states:

> The articles of incorporation may contain any provision not inconsistent with this act or any other statute of this state, for management of the business and conduct of the affairs of the corporation, or creating, defining, limiting or regulating the powers of the corporation, its directors and shareholders or any class of shareholders including any provision which under this act is required or permitted to be set forth in the bylaws.

Id.

21. *Id.* § 450.1455 (MICH. STAT. ANN. § 21.200(455)) (greather-than-majority voting provisions are of great value particularly to close corporations). *See infra* note 93 and accompanying text.

22. MICH. COMP. LAWS § 450.1442 (MICH. STAT. ANN. § 21.200(442)).

23. *Id.* § 450.1351 (MICH. STAT. ANN. § 21.200(351)) (provision limiting board of director's discretion over dividend policy).

24. *Id.* § 450.1473 (MICH. STAT. ANN. § 21.200(473)).

25. *Id.* § 450.1407 (MICH. STAT. ANN. § 21.200(407)).

26. *Id.* § 450.1481 (MICH. STAT. ANN. § 21.200(481)(2)).

27. *Id.* § 450.1231 (MICH. STAT. ANN. § 21.200(231)). This section provides in relevant part:

> The initial bylaws of a corporation shall be adopted by its incorporators, its shareholders or its board. The shareholders or the board may amend or repeal the bylaws or adopt new bylaws unless power to do so is reserved exclusively to the shareholders by the articles of incorporation. The shareholders may prescribe in the bylaws that any bylaw made by them shall not be altered or repealed by the board. The bylaws may contain any provision for the regulation and management of the affairs of the corporation not inconsistent with law or the articles of incorporation.

Id.

28. *Id.* §§ 450.1461, 450.1463 (MICH. STAT. ANN. §§ 21.200(461), 21.200(463)). Under section 450.1461: "[a]n agreement between 2 or more shareholders, if in writing and signed by the parties thereto, may provide that in exercising 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." Section 450.1463 states:

> (1) [Notwithstanding other provisions of this act,] a provision in the articles of incorporation may provide that there shall [not] be♦[a] board of directors, or may restrict the board in its management of the business of the corporation, or may delegate to 1 or more shareholders or other persons,♦[a] part of [the] management otherwise within the authority of the board, if all the incorporators have authorized the provision in the articles or the holders of record of all outstanding shares have authorized the provision in an amendment to the articles.

to the specific needs of the close corporation. The bylaws are useful as a planning device, since a close corporation may tailor them to fit the particular skills and personalities of the participating shareholders.[29] In Michigan, the bylaws, like the articles, may be used to regulate and limit board discretion.[30] The bylaws may prescribe that only the shareholders may alter or repeal bylaws made by them.[31] Matters of internal management and operation should be covered in the bylaws which facilitate quick change if necessary.[32] A Michigan court may, however, invalidate a bylaw on the grounds that it is unreasonable.[33]

2. Financial Structure

In accordance with the Act, authorized shares may be divided into classes and any class of shares may further be divided into and issued in series.[34] The articles authorize the board to set the terms

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Invalidity of provision.] (2) A provision authorized by subsection (1) becomes invalid in either of the following cases:

(a) Subsequent to the adoption of the provision, shares are transferred or issued to a person who takes delivery of the share certificate without notice [of the provision], unless [that] person consents in writing to the provision.

(b) Shares of the corporation are listed on a national securities exchange or regularly quoted in an over-the-counter market by 1 or more members of a national or affiliated securities association.

Effect of provision.] (3) The effect of a provision authorized by subsection (1) is to relieve the directors and impose upon the shareholders the liability for managerial acts or omissions that is imposed on directors by law to the extent that, and [as] long as, the discretion or powers of the directors in their management of corporate affairs is controlled by ♦ [the] provision.

Notation on certificates; taking with notice.] (4) If the articles contain a provision authorized by subsection (1), the existence of the provision shall be noted conspicuously on the face of every certificate for shares issued by the corporation, and a holder of [that] certificate is conclusively ♦ [considered] to have taken delivery with notice of the provision. *Id.*

29. *Id.* § 450.1261 (MICH. STAT. ANN. § 21.200(261)(d)) (provision dealing with duties and powers of officers). *See also* F. O'NEAL, *supra* note 1, § 3.73.

30. MICH. COMP. LAWS § 450.1231 (MICH. STAT. ANN. § 21.200(231)); *supra* note 27 (text of this provision).

31. *See supra* note 27.

32. *See* F. O'NEAL, *supra* note 1, at § 3.73.

33. The bylaws of any corporation must be reasonable. Dozier v. Automobile Club of Mich., 69 Mich. App. 144, 244 N.W.2d 376 (1976); Allnutt v. Subsidiary High Court of U.S. Ancient Order of Foresters, 62 Mich. 110, 28 N.W. 802 (1886).

34. MICH. COMP. LAWS §§ 450.1301, 1302 (MICH. STAT. ANN. §§ 21.200(301),

of each series.[35] Although perhaps used more frequently by public corporations, this power may be valuable to small corporations.[36] For example, the articles of incorporation may authorize the issuance of a single class of preferred stock. The board may establish various series within that class carrying different dividend rates to ensure availability of capital as market conditions change.[37]

.200(302)). Section 450.1301 provides in relevant part:

> (1) A corporation may issue the number of shares authorized in its articles of incorporation. The shares may be all of 1 class or may be divided into 2 or more classes. Each class shall consist of shares with par value or shares without par value, having such designations and such relative voting, dividend, liquidation and other rights, preferences and limitations, consistent with this act, as stated in the articles of incorporation. The articles may deny, limit or otherwise prescribe the voting rights and may limit or otherwise prescribe the dividend or liquidation rights of shares of any class.

35. Section 450.1302 provides in relevant part:

> (1) If the articles of incorporation so provide, the shares of a class of stock may be divided into and issued in series. If the shares of such a class are to be issued in series, each series shall be so designated as to distinguish the shares thereof from the shares of the other series and classes.
>
> . . . .
>
> (3) If the articles of incorporation authorize the board, to the extent that the articles have not established series and prescribed variations in the relative rights and preferences as among series, the board may divide any class into series, and, within the limitations set forth in the articles, prescribe the relative rights and preferences of the shares of any such series.
>
> (4) A certificate containing the resolution of the board establishing and designating the series and prescribing the relative rights and preferences thereof shall be filed, and when filed shall constitute an amendment to the articles of incorporation.

36. *See* R. SCHMIDT & Z. CAVITCH, MICHIGAN CORPORATION LAW WITH FEDERAL TAX ANALYSIS § 1.68(13) (1985) [hereinafter cited as R. SCHMIDT & Z. CAVITCH]. The corporation has wide powers to authorize varying kinds of stock involving many lawful incidents as to preferences, rights, and privileges by utilizing § 21.200(301) and § 21.200(302). *See also supra* note 35.

37. S. SIEGEL, MICHIGAN BUSINESS CORPORATIONS § 3.03 (1979) [hereinafter cited as S. SIEGEL]. *See also* R. SCHMIDT & Z. CAVITCH, *supra* note 36, § 211(2)(h):

> The authority granted to the board to fill in provisions at a later date is a flexible aid to financing to enable the board to meet the exigencies of negotiations for acquisition of other corporate properties or the issuance of securities without necessitating shareholder action. Such stock is typically referred to as "blank" stock because it is analgous [sic] to a blank check authorizing the holder to fill in appropriate amounts. Typical variations common under prior law include dividend rate and participation, redemption terms, liquidation payments, sinking funds provisions and conversion terms but the present statute allows for other variations alone or in combination.

The Act is novel since it permits both future services and future payments to be adequate consideration for current issuance of stock.[38] It also allows considerable flexibility in permitting a corporation to buy back its own shares.[39] This is an important consideration in close corporations, since redemption provides an alternative to buy-sell agreements.[40]

3. Shareholder Rights

The key to close corporation planning is the relationship between shareholder rights and corporate governance. The Act validates a number of devices often used by close corporations to meet the special needs of its shareholders.

First, a provision is made for informal shareholder action.[41] Close corporations, especially family-oriented corporations, frequently ignore operational formalities.[42] To insure the validity of such informal arrangements, provisions should be included in the articles to allow for corporate action to be taken without notice, without a meeting, and without a vote.[43] The Act permits a shareholder to

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38. MICH. COMP. LAWS § 450.1315 (MICH. STAT. ANN. § 21.200(315)). The Model Business Corporation Act § 6.2 (3d ed. 1985) provides:

> (e) The corporation may place in escrow shares issued for a contract for future services or benefits or a promissory note, or make other arrangements to restrict the transfer of the shares, and may credit distributions in respect of the shares against their purchase price, until the services are performed, the note is paid, or the benefits received. If the services are not performed, the note is not paid, or the benefits are not received, the shares escrowed or restricted and the distributions credited may be cancelled in whole or part.

39. MICH. COMP. LAWS § 450.1365, .1366, .1367 (MICH. STAT. ANN. §§ 21.200(365), (366), (367)).

40. S. SIEGEL, *supra* note 37, § 3.14.

41. For example, under section 450.1405 of the Act, shareholders may participate in a meeting of shareholders by conference telephone:

> A corporation may provide in its articles of incorporation or in its bylaws for a shareholder's participation in a meeting of shareholders by a conference telephone or similar communications equipment by which all persons participating in the meeting may hear each other if all participants are advised of the communications equipment and the names of the participants in the conference are divulged to all participants. Participation in a meeting pursuant to this section constitutes presence in person at the meeting.

42. *See* F. O'NEAL, *supra* note 1, § 8.02.

43. MICH. COMP. LAWS § 450.1407(1) (MICH. STAT. ANN. § 21.200(407)(1)) provides:

> (1) The articles of incorporation may provide that any action required or permitted by this act to be taken at an annual or special meeting of

consent in writing to a corporate action, provided that a sufficient number of shareholders favor the action to have carried a vote at a shareholders' meeting. The consents must correspond to the action taken.[44] Even without such a provision in the articles, unanimous written consent without a meeting or prior notice is permitted under Michigan law.[45]

Second, several provisions relate to shareholder meetings.[46] Attendance at a shareholder meeting constitutes waiver of notice unless the shareholder attends only to object, at the outset of the meeting, to the conduct of business.[47] A requirement of lesser or greater than majority shareholder attendance to constitute a quorum may be imposed by the articles or bylaws.[48] The articles may also impose a greater than majority voting requirement for any action.[49] Amending the articles to change or delete the supermajority provision requires

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shareholders may be taken without a meeting, without prior notice and without a vote, if a consent in writing, setting forth the action so taken, is signed by the holders of outstanding stock having not less than the minimum number of votes that would be necessary to authorize or take the action at a meeting at which all shares entitled to vote thereon were present and voted. Prompt notice of the taking of the corporate action without a meeting by less than unanimous written consent shall be given to shareholders who have not consented in writing.

44. *Id.*

45. *Id.* § 450.1407(3) (MICH. STAT. ANN. § 21.200(407)(3)) provides: "(3) Any action required or permitted by this act to be taken at an annual or special meeting of shareholders may be taken without a meeting, without prior notice and without a vote, if all the shareholders entitled to vote thereon consent thereto in writing."

46. *See infra* notes 47-52 and accompanying text.

47. MICH. COMP. LAWS § 450.1404(3) (MICH. STAT. ANN. § 21.200(404)(3)) states:

(3) Attendance of a person at a meeting of shareholders, in person or by proxy, constitutes a waiver of notice of the meeting, except when the shareholder attends a meeting for the express purpose of objecting, at the beginning of the meeting, to the transaction of any business because the meeting is not lawfully called or convened.

48. *Id.* § 450.1415(1) (MICH. STAT. ANN. § 21.200(415)(1)). This section also provides that once quorum requirements have been met, a meeting may continue despite the withdrawal of shareholders which results in less than the statutory quorum requirement.

49. *Id.* § 450.1455 (MICH. STAT. ANN. § 21.200(455)). This section provides in relevant part:

When, with respect to an action to be taken by the shareholders, the articles of incorporation require the vote or concurrence of the holders of a greater proportion of the shares, or of a class or series thereof, than required by this act with respect to the action, the articles shall control.

no less than the number of votes which the provision itself requires.[50] If the incorporators or shareholders so desire, the articles may provide for cumulative voting in the election of directors.[51] However, the statutory presumption is against cumulative voting.[52]

A third feature of the Act is the liberal provision for voting agreements between two or more shareholders.[53] Voting agreements generally may bind the parties "to vote their shares for specified persons as directors, to vote as a majority of the shares in the pool may decide, or to vote as an arbitrator may direct in the event of disagreement."[54] Voting agreements may give certain shareholders voting power disproportionate to their actual holdings of voting shares. Such a device may be needed in a close corporation where key shareholders own relatively little voting stock.[55] Some states which have statutes validating shareholder agreements do not place a maximum limit on the agreement's duration.[56] Other states limit the

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An amendment of the articles which adds, changes or deletes such a provision shall be authorized by the vote required to amend the articles pursuant to section 611, or by the same vote as would be required to take action under such provision, whichever is greater.

50. *Id.*

51. *Id.* § 450.1451 (MICH. STAT. ANN. § 21.200(451)), provides that: [t]he articles of incorporation may provide that a shareholder entitled to vote at an election for directors may vote, in person or by proxy, the number of shares owned by him for as many persons as there are directors to be elected and for whose election he has a right to vote, or to cumulate his votes by giving 1 candidate as many votes as the number of such directors multiplied by the number of his shares, or by distributing his votes on the same principle among any number of the candidates.

52. *Id.*

53. *Id.* § 450.1461 (MICH. STAT. ANN. § 21.200(461)). The Act provides for: [a]n agreement between 2 or more shareholders, if in writing and signed by the parties thereto, may provide that in exercising 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.

Id.

54. F. O'NEAL, *supra* note 1, § 5.12.

55. The Michigan voting rights statute, which mirrors the New York Statute (N.Y. Bus. Corp. Law § 620(a) (Consol. 1961)), provides support for agreements which give voting power disproportionate to shares held. *Id.*

56. A few states sanction shareholders' agreements for an unlimited time for both publicly-held and close corporations. *See, e.g.,* N.J. REV. STAT. § 14A:5-21(1) (1968); N.Y. BUS. CORP. LAW § 620(a) (Consol. 1961). Several other states sanction unlimited shareholder agreements but only for close corporations. *See, e.g.,* DEL. CODE ANN. tit. 8, § 350 (1967); FLA. STAT. ANN. § 607.107 (West 1975); MD. GEN. COMP. LAWS § 2-510 (1975); PA. STAT. ANN. tit. 15, § 1381 (Purdon 1959).

duration of the shareholder agreement to ten years,[57] with some statutes allowing an extension of an additional period not exceeding ten years.[58] Michigan does not limit the duration of voting agreements.[59] The legality of voting agreements depends largely on the purpose sought to be attained by the agreement.[60] Compliance under the Act may be strengthened via the use of an irrevocable proxy executed pursuant to the Act.[61]

The flexibility of voting agreements makes their use preferable to the more cumbersome and rigid voting trust device.[62] If used, a voting trust may be created for a term of ten years, renewable within twelve months before its expiration.[63] Upon expiration of the ten year period, the voting trust is not binding on any shareholder refusing to consent to an extension.[64]

Fourth, the Act validates shareholder agreements which in essence allows a corporation to operate without a board of directors—in effect an incorporated partnership.[65] The agreements may limit the discretion of the board to manage the corporation,[66] especially when used in conjunction with the articles or bylaws.[67] Control agreements may be used to designate the officers of the corporation, name key employees, fix salaries, and specify conditions under which dividends may be declared.[68]

Unlike simple voting agreements, shareholder control agreements must either be adopted by all the incorporators and placed in the

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57. *E.g.*, CONN. GEN. STAT. ANN. § 33-339(b) (West 1958); DEL. CODE ANN. tit. 8, § 218(c); N.C. GEN. STAT. § 55-73(a) (1981); S.C. CODE ANN. § 33-11-160 (Law. Co-op. 1976).

58. *See, e.g.*, CONN. GEN. STAT. ANN. § 33-339(b) (two years); DEL. CODE ANN. tit. 8, § 218(c) (two years); S.C. CODE ANN. § 33-11-160 (one year). For further discussion, see F. O'NEAL, *supra* note 1, § 5.07.

59. MICH. COMP. LAWS § 450.1461 (MICH. STAT. ANN. § 21.200(461)).

60. F. O'NEAL, *supra* note 1, § 5.08.

61. S. SIEGEL, *supra* note 37, § 4.14. Proxies are valid for three years unless provided for otherwise. *See* MICH. COMP. LAWS § 450.1421 (MICH. STAT. ANN. § 21.200(421)).

62. *See* S. SIEGEL, *supra* note 37, § 4.14.

63. MICH. COMP. LAWS § 450.1466 (MICH. STAT. ANN. § 21.200(466)).

64. *Id.* § 450.1468 (MICH. STAT. ANN. § 21.200(468)).

65. *See supra* note 28 and accompanying text. This assures limited liability while maintaining an informal, partnership-like structure. *See* F. O'NEAL, *supra* note 1, § 1.07.

66. *See supra* note 28 and accompanying text.

67. MICH. COMP. LAWS § 450.1501 (MICH. STAT. ANN. § 21.200(501)).

68. *Id.* § 450.1531 (MICH. STAT. ANN. § 21.200(531)). *See also* F. O'NEAL, *supra* note 1, § 5.02.

original articles or authorized by all shareholders in an amendment to the articles.[69] Control agreements terminate automatically if the close corporation's shares are listed on a national exchange or regularly quoted on an over-the-counter market.[70] Termination also occurs if shares are transferred to a person who takes delivery without notice of the control agreement.[71] Existence of a control agreement must be conspicuously noted on the face of all stock certificates.[72] To the extent that the control agreement limits the discretion of the directors, liability usually imposed upon the directors is instead placed upon the shareholders.[73] In drafting control agreements, the corporation's attorney may wish to include a remedial provision to take effect when any occurrence terminating the control agreement takes place.[74]

Fifth, a shareholder agreement, the articles, or the bylaws may impose restrictions on the transfer of shares.[75] Such restrictions should be noted on the stock certificates.[76] The Act expressly validates the

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69. *See supra* note 28 and accompanying text.

70. *Id.*

71. *Id.* Adequate notice is provided if the existence of the provision is noted on the face of every certificate for shares issued by the corporation.

72. MICH. COMP. LAWS ANN. § 450.1463(2)(a), (4) (MICH. STATE. ANN. § 21.200(463)(2)(a), (4)).

73. *Id.* § 450.1463(3) (MICH. STAT. ANN. § 21.200(463)(3)). Under the Act, the corporate director is charged with a duty of good faith and with a duty of diligence, care, and skill which an ordinary prudent person would exercise under similar circumstances in a like position. *Id.* § 450.1541 (MICH. STAT. ANN. § 21.200(541)).

A provision in the articles of incorporation may restrict the duties of the directors. In the event a provision is used, the duties restricted to directors will be transferred to the shareholders. *Id.* § 450.1463 (MICH. STAT. ANN. § 21.200(463)).

For agreements that were held valid, see Galler v. Galler, 32 Ill. 2d 16, 203 N.E.2d 577 (1964), *reh'g denied*, 95 Ill. App. 2d 340, 238 N.E.2d 274 (1968); Clark v. Dodge, 269 N.Y. 410, 199 N.E. 641 (1936). *But see* Long Park, Inc. v. Trenton-New Brunswick Theatres Co., 297 N.Y. 174, 77 N.E.2d 633 (1948).

74. *See* DEL. CODE ANN. tit. 8, § 348 (1983) (describing a 30-day grace period during which the terminating occurrence might be reversed or corrected without a loss of close corporation status).

75. MICH. COMP. LAWS § 450.1472(1) (MICH. STAT. ANN. § 21.200(472)(1)). *See* Fletcher v. Kentucky Inn, Inc., 88 Mich. App. 456, 276 N.W.2d 619 (1979); Groves v. Pricket, 420 F.2d 1119 (9th Cir. 1979).

Section 450.1472(1) provides in relevant part that: "[a] restriction on the transfer or registration of transfer of a bond or share of a corporation may be imposed either by the articles of incorporation or by the bylaws or by an agreement among any number of holders or among such holders and the corporation."

76. MICH. COMP. LAWS § 450.1472(2) (MICH. STAT. ANN. § 21.200(472)(2)).

The Uniform Commercial Code provides that a restriction on the transfer of the stock is ineffective against any person without knowledge unless the restriction

most common forms of transfer restrictions: (a) right of first refusal to the corporation or other shareholders, (b) buy-out obligations, (c) consent requirements, (d) prohibitions on transfer to designated persons or classes of persons, and (e) restraints for the purpose of preserving S corporation status.[77]

Finally, close corporation shareholders may prefer to establish preemptive rights as a means of protecting their proportional holdings and voting power. Preemptive rights may be established in the articles of incorporation or by a shareholder agreement in accordance with the Act.[78]

4. Management Structure

Elimination of the board is one of the control devices available under the Act. If the board of directors is not eliminated, the Act provides that the board may consist of one or more members.[79] The classification of directors, another control device permitted by the Act, allows the election of directors to terms of a maximum of three years.[80] The statute does not set a minimum size for a classified board; a classified board may consist of two or three members with one director in each class. Another permissible control device is a provision in the articles of incorporation which allows for one or more directors to be elected exclusively by the shareholders of one class or series.[81]

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is conspicuously placed on the certificate or another relevant document. U.C.C. § 8-204 (1977).

77. MICH. COMP. LAWS § 450.1473 (MICH. STAT. ANN. § 21.200(473)).

78. *Id.* § 450.1481(1) (MICH. STAT. ANN. § 21.200(481)(1)). The statute, in relevant part, states that "[e]xcept as otherwise provided in the articles of incorporation or by agreement, a corporation may issue or deliver unissued or treasury shares, option rights, or securities having conversion or option rights, without first offering them to existing shareholders."

79. *Id.* § 450.1505(1) (MICH. STAT. ANN. § 21.200(505)(1)).

80. *Id.* § 450.1506(1) (MICH. STAT. ANN. § 21.200(506)(1)). The statute provides in relevant part that:

> [t]he articles of incorporation or a bylaw adopted by the shareholders may provide that in lieu of annual election of all directors the directors be divided into 2 or 3 classes, each to be as nearly equal in number as possible. The term of office of directors in the first class shall expire at the first annual meeting of shareholders after their election, that of the second class shall expire at the second annual meeting after their election, and that of the third class, if any, shall expire at the third annual meeting after their election.

81. *Id.* § 450.1506(2) (MICH. STAT. ANN. § 21.200(506)(2)).

The Act presumes that a majority of the directors currently in office constitutes a quorum for transaction of business, and that a majority vote of members present at a meeting having a quorum present is sufficient for approval of an action.[82] These rules may be changed in the articles of incorporation or bylaws, which would allow for increase or decrease in quorum requirements, and an increase (but not decrease) in the number of votes required to approve an action.[83] Unless otherwise provided in the articles of incorporation or bylaws, the board may act without a meeting if the directors give unanimous written consent.[84] If the board's power to elect officers is removed (or if there is no board), arrangements for election of officers should be included in the shareholder control agreement in order to assure the validity of election procedures.[85]

Theoretically, a close corporation might operate with a single individual holding all of the required officer positions. Practically, a corporation must have two officers, since the Act requires two

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82. *Id.* § 450.1523 (MICH. STAT. ANN. § 21.200(523)). Section 450.1523 of the Michigan Compiled Laws states, in relevant part, that:

> [a] majority of the members of the board then in office, or of the members of a committee thereof, constitutes a quorum for transaction of business, unless the articles of incorporation or bylaws provide for a larger or smaller number. The vote of the majority of members present at a meeting at which a quorum is present constitutes the action of the board or of the committee, unless the vote of a larger number is required by this act, the articles or the bylaws.

83. *Id.*

84. *Id.* § 450.1525 (MICH. STAT. ANN. § 21.200(525)). The statute provides in relevant part that:

> [u]nless otherwise provided by the articles of incorporation or bylaws, action required or permitted to be taken pursuant to authorization voted at a meeting of the board or a committee thereof, may be taken without a meeting if, before or after the action, all members of the board or of the committee consent thereto in writing. The written consents shall be filed with the minutes of the proceedings of the board or committee.

85. *Id.* § 450.1463 (MICH. STAT. ANN. § 21.200(463)(1)). The statute provides in relevant part:

> Notwithstanding other provisions of this act, a provision in the articles of incorporation may provide that there shall not be a board of directors, or may restrict the board in its management of the business of the corporation, or may delegate to 1 or more shareholders or other persons, a part of the management otherwise within the authority of the board, if all the incorporators have authorized the provision in the articles or the holders of record of all outstanding shares have authorized the provision in an amendment to the articles.

See also S. SIEGEL, *supra* note 37, § 4.15.

official signatures on stock certificates,[86] and banks will normally require two signatures in executing documents.[87]

5. Amendment to Articles of Incorporation; Fundamental Changes in Corporate Identity

The chapter in the Act concerning amendments to the articles of incorporation is useful because many of the control devices employed by close corporations may be contained within the articles. Shareholders may vote as a class on a proposed amendment, even when they hold nonvoting stock, if the amendment would have an adverse effect on the class.[88] Class voting, used as a protective device, may be written into the articles of incorporation.[89]

A holder of "adversely affected" shares who does not vote for an amendment may dissent and demand payment for the shares if the amendment: (a) materially alters or abolishes a preferential right, or (b) creates, alters, or abolishes a material provision or right in respect of the redemption of such shares.[90] Thus, the category of amendments which triggers this right is more narrowly defined than the category entitling holders to a class vote.[91] A dissenting shareholder is entitled to receive payment no greater than the amount payable on redemption of the shares or on liquidation of the corporation, whichever is less.[92]

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86. MICH. COMP. LAWS § 450.1331 (MICH. STAT. ANN. § 21.200(331)).

Section 450.1331 of the Michigan Compiled Laws provides that "[t]he shares of a corporation shall be represented by certificates signed by the chairman of the board, vice-chairman of the board, president or a vice-president and by the treasurer, assistant treasurer, secretary or assistant secretary of the corporation." *See also* S. SIEGEL, *supra* note 37, § 5.07.

87. *See* S. SIEGEL, *supra* note 37, § 5.07.

88. MICH. COMP. LAWS § 450.1615(1) (MICH. STAT. ANN. § 21.200(615)(1)). The statute provides in relevant part that:

> [t]he holders of the outstanding shares of a class may vote as a class upon a proposed amendment, whether or not entitled to vote thereon by the articles of incorporation, if the amendment would increase or decrease the aggregate number of authorized shares of the class, or alter or change the powers, preferences or special rights of the shares of the class or other classes so as to affect the class adversely.

89. *See* S. SIEGEL, *supra* note 37, § 6.05.

90. MICH. COMP. LAWS § 450.1621 (MICH. STAT. ANN. § 21.200(621)).

91. *Id.* § 450.1615 (MICH. STAT. ANN. § 21.200(615)). *See* Russ v. Federal Mogul Corp., 122 Mich. App. 449, 316 N.W.2d 454 (1982); Bruno, *Business Associations,* 29 WAYNE L. REV. 329, 339 (1983).

92. MICH. COMP. LAWS § 450.1621(2) (MICH. STAT. ANN. § 21.200(621)(2))

Although mergers, consolidations, and sales of assets outside the usual course of business may normally be approved by a simple majority of the outstanding shares,[93] an amendment to the articles may require a higher vote. This often provides an important protection for minority shareholders. Even when a simple majority can approve such a fundamental change, the appraisal remedy is available to dissenting shareholders.[94] A typical effect of the appraisal right is to force a compromise between the majority who desire a fundamental change in the corporation, and the dissenters who refuse to be forced into a position different from that bargained for when the stock was purchased.

6. Devices for Rectifying Internal Dissension

Dissolution may occur voluntarily or by court order. Voluntary dissolution often results when conditions set forth in the articles of incorporation are met.[95] The value of allowing dissolution at will or upon the occurrence of a specified event can be great for close corporations. Shareholders' or directors' death, retirement, or deadlock will cause considerable difficulty for close corporations; yet standards for judicial intervention in many states are so stringent that courts will seldom grant a remedy.[96] Even when the relevant standards are satisfied, a petition for judicial dissolution or other remedy may result in lengthy proceedings, and the legal fees may be beyond the company's financial capability. Advance agreement on dissolution-causing events can avoid these problems, although these advantages must be weighed against other potential problems, such as potential abuse of the device by shareholders.[97] The Act is quite valuable to a close corporation wishing to operate as a quasi-partnership, because an individual shareholder may be able to rely

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(§ 2 puts a reasonable limit on the amount a dissenting shareholder may receive). *See generally* Pollock, *Business Associations,* 28 WAYNE L. REV. 553, 570-72 (1982).

93. MICH. COMP. LAWS §§ 450.1703(2), .1753(4) (MICH. STAT. ANN. §§ 21.200(703)(2), (753)(4)). *See also* Porter v. C.O. Porter Mach. Co., 336 Mich 437, 58 N.W.2d 135 (1953); Miller v. Magline, Inc., 105 Mich. App. 413, 306 N.W.2d 533 (1981).

94. MICH. COMP. LAWS § 450.1768(1) (MICH. STAT. ANN. § 21.200(768)(1)). The procedure for appraisal is covered by MICH. COMP. LAWS § 450.1761-.1771 (MICH. STAT. ANN. § 21.200(760)-(771)).

95. *Id.* § 450.1805 (MICH. STAT. ANN. § 21.200(805)).

96. *See* S. SIEGEL, *supra* note 37, §§ 8.03, .05.

97. *Id.* § 8.03. *See generally* B. BITTKER & J. EUSTICE, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS ch. 11 (4th ed. 1979).

on an agreement specifying the conditions triggering dissolution. This agreement may serve as a deterrent to directors or controlling shareholders, thus protecting the minority shareholder's interest.

Further protection from deadlock and oppression is afforded by the Act's lenient standard for dissolution by court order.[98] A court is empowered to dissolve the enterprise even though the deadlocked corporation is operating at a profit.[99] Furthermore, if the directors or shareholders are so divided that they have been unable to elect successors to directors whose terms have expired, dissolution may be ordered. [100] This is a major departure from the approach used elsewhere in which courts have refused to intervene and dissolve the corporation unless insolvency is imminent.[101]

The Act also provides that a court may use equitable remedies in the event a shareholder can show that "the acts of the directors or those in control of the corporation are illegal, fraudulent or wilfully unfair and oppressive to the corporation or to such shareholder."[102] In these situations, the court may either order dissolution of the corporation or utilize less drastic remedies, which include changes in the articles or bylaws, cancellation of or injunction against a resolution or other act of the corporation, and prohibition or direction of an act of the corporation or other parties.[103] The court may also

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98. MICH. COMP. LAWS § 450.1823 (MICH. STAT. ANN. § 21.200(823)).

The Model Business Corporation Act limits dissolution to those situations in which irreparable injury is threatened; therefore, unless insolvency is imminent, the court will deny dissolution. Model Business Corp. Act. § 97 (1979). *See In re* Radom & Neidorff, Inc., 307 N.Y. 1, 119 N.E.2d 563 (1954). However, the Act provides for dissolution based on the interests of the parties notwithstanding the solvency of the corporation. MICH. COMP. LAWS § 450.1823 (MICH. STAT. ANN. § 21.200(823)). The Michigan Compiled Laws provide for dissolution when:

> [t]he directors of the corporation, or its shareholders . . . are unable to agree by the requisite vote on material matters respecting management of the corporation's affairs, or the shareholders of the corporation are so divided in voting power that they have failed to elect successors to any director whose term has expired or would have expired upon the election and qualification of his successor.

Id.

99. *See* Salvadore v. Connor, 87 Mich. App. 664, 276 N.W.2d 458 (1978).

100. MICH. COMP. LAWS § 450.1823 (MICH. STAT. ANN. § 21.200(823)).

101. *See In re* Radom & Neidorff, Inc., 307 N.Y. 1, 119 N.E.2d 563 (1954).

102. MICH. COMP. LAWS § 450.1825(1) (MICH. STAT. ANN. § 21.200(825)(1)). *See also* Detroit Steel Prod. Co. v. Hewer, 232 Mich. 55, 204 N.W. 691 (1925); Salvadore v. Connor, 87 Mich. App. 664, 276 N.W.2d 458 (1978); Barnett v. International Tennis Corp., 80 Mich. App. 396, 263 N.W.2d 908 (1978).

103. MICH. COMP. LAWS § 450.1825 (MICH. STAT. ANN. § 21.200(825)). *See generally* Hillman, *The Dissatisfied Participant in the Solvent Business Venture: A Consideration*

direct that the corporation or the individuals responsible for the wrongful acts purchase shares at a fair price.[104]

Although dissolution is still considered to be a drastic remedy, equitable remedies provided by statute give the courts great flexibility in fashioning relief appropriate to the particular situation.[105] Previously, courts were reluctant to intervene except to dissolve, and dissolution was considered to be an extreme remedy to be used only as a last resort.[106]

Under the Act, other equitable relief may be used when the circumstances warrant a remedy short of dissolution.[107] For example, in *Moore v. Carney*[108] the corporation was ordered to purchase the plaintiff's stock interests, thereby preventing dissolution. This decision follows the spirit of the Act by striving to find an alternative resolution to the conflict. In situations prior to the enactment of the Act, the court would have only intervened to order dissolution. In *Barnett v. International Tennis Corp.*,[109] however, the court ignored the alternative relief (buying out the plaintiff's stock interest) made expressly available by statute and determined that the situation was not so grave as to warrant dissolution.

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of the Relative Performance of Partnerships and Close Corporations, 67 MINN. L. REV. 1, 35-55 (1983).

104. MICH. COMP. LAWS § 450.1825 (MICH. STAT. ANN. § 21.200(825)). *See also* Moore v. Carney, 84 Mich. App. 399, 269 N.W.2d 614 (1978).

105. MICH. COMP. LAWS § 450.1825(2) (MICH. STAT. ANN. § 21.200(825)(2)). The statute provides for such action as:

> (a) Cancellation or alteration of a provision contained in the articles of incorporation, or an amendment thereof, or in the bylaws of the corporation.
>
> (b) Cancellation, alteration or injunction against a resolution or other act of the corporation.
>
> (c) Direction or prohibition of an act of the corporation or of shareholders, directors, officers or other persons party to the action.
>
> (d) Purchase at their fair value of shares of a shareholder, either by the corporation or by the officers, directors or other shareholders responsible for the wrongful acts.

106. *See* S. SIEGEL, *supra* note 37, § 8.06; Levant v. Kowal, 350 Mich. 232, 86 N.W.2d 336 (1957); Stott Realty v. Orloff, 262 Mich. 375, 247 N.W. 698 (1933).

107. *See* S. SIEGEL, *supra* note 37, § 8.06.

108. 84 Mich. App. 399, 269 N.W.2d 614 (1978) (Plaintiff, a minor shareholder, brought an action against corporation and directors claiming mismanagement and oppression.).

109. 80 Mich. App. 396, 263 N.W.2d 908 (1978) (Plaintiff was a shareholder while defendants were shareholders and managers of the corporation. Defendants' salary was increased without consent of plaintiff.).

B. The Delaware Statute

Special provisions governing Delaware close corporations are in many respects easier to locate and summarize than the Michigan provisions because they are found in a separate subchapter of the Delaware General Corporation Law.[110] However, general corporation law principles apply even to close corporations governed by the subchapter, unless the subchapter provides otherwise.[111] For example, general corporate law provisions allowing for corporate action without a meeting[112] apply whether or not the corporation falls within the close corporation subchapter.

A close corporation is defined in the subchapter as "one which disavows a public offering of its securities, restricts in some way the transfer of its shares, places a limit on the number of its shareholders not to exceed thirty . . . , and recites in its certificate of incorporation that it is a close corporation."[113] Election of close corporation status is voluntary for both new and existing corporations.[114] An existing corporation which meets the close corporation requirements can become a statutory close corporation by a charter amendment approved by two-thirds of the holders of each class of stock.[115]

A Delaware provision not in the close corporation subchapter permits a one-person board of directors.[116] In addition, the close corporation subchapter allows the shareholders, rather than the board, to manage the corporation.[117] All shareholders must approve such a

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110. DEL. CODE ANN. tit. 8, §§ 341-356 (1983).

111. *Id.* § 341(b).

112. *Id.* §§ 108(c), 141(f), 228.

113. Bradley, *A Comparative Evaluation of the Delaware and Maryland Close Corporation Statutes*, 1968 DUKE L.J. 525, 527 (1968). *See* DEL. CODE. ANN. tit. 8, § 342(c) (requires that stock held jointly, in common or by the entireties be attributed to one stockholder).

114. DEL. CODE ANN. tit. 8, § 344.

115. *Id. But see* DEL. CODE ANN. tit. 8, § 349 (shareholders who do not elect close corporation status have an appraisal remedy).

Section 344 of title 8 of the Delaware Code provides in relevant part that:

> [a]ny corporation organized under this chapter may become a close corporation . . . by executing, acknowledging, filing and recording, . . . a certificate of amendment of its certificate of incorporation which shall contain a statement that it elects to become a close corporation, . . . and a heading stating the name of the corporation and that it is a close corporation. Such amendment . . . must be approved by a vote of the holders of record of at least two thirds of the shares of each class of stock of the corporation which are outstanding.

116. *Id.* § 141(b).

117. DEL. CODE ANN. tit. 8, § 351 provides in relevant part that:

> [t]he certificate of incorporation of a close corporation may provide

provision. Another section provides that a written agreement among the holders of a majority of a close corporation's outstanding voting stock is not invalid on the grounds that it restricts the discretion or powers of the board of directors.[118] Such an agreement relieves the directors of their usual liability for managerial acts, and imposes that liability upon shareholders who are parties to the agreement.[119] Yet another section states that no written agreement "among stockholders" nor any provision in the certificate of incorporation or the bylaws relating to any phase of the corporation's affairs shall be invalid on the ground that it is an attempt to treat the corporation as a partnership.[120]

The subchapter provides for a two-thirds vote to voluntarily terminate close corporation status by amending the certificate of incorporation to delete a required provision such as the limitation on the number of shareholders or the restriction on public trading; however, a higher vote may be required by the charter.[121] Close corporation status will be involuntarily terminated if an event occurs which breaches one of the qualifying conditions for such status.[122] The company or its shareholders may, however, "[w]ithin 30 days

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that the business of the corporation shall be managed by the stockholders of the corporation rather than by a board of directors. . . . Such a provision may be inserted in the certificate of incorporation by amendment if all incorporators and subscribers or all holders of record of all of the outstanding stock, whether or not having voting power, authorize such a provision.

118. DEL. CODE ANN. tit. 8, § 350. This section only applies under § 341 to a close corporation within the statutory definition which elects to be treated as such under § 344. *See* Chapin v. Benwood Found., Inc., 402 A.2d 1205 (Del. Ch. 1979), *aff'd sub nom.*, Harrison v. Chapin, 415 A.2d 1068 (Del. 1980).

119. *See supra* note 118.

120. DEL. CODE ANN. tit. 8, § 354. *See generally* Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663, 702 (1974).

121. DEL. CODE ANN. tit. 8, § 346. The statute provides in relevant part that:

[t]he certificate of incorporation of a close corporation may provide that on any amendment to terminate its status as a close corporation, a vote greater than two thirds or a vote of all shares of any class shall be required; and if the certificate of incorporation contains such a provision, that provision shall not be amended, repealed or modified by any vote less than that required to terminate the corporation's status as a close corporation.

Id. § 346(b).

122. *Id.* § 345(b). Section 345 provides that close corporation status will be involuntarily terminated if any one of the provisions or conditions permitted by section 342 has, in fact, been breached. The provisions in section 342(a) include:

(1) All of the corporation's issued stock of all classes, exclusive of treasury shares, shall be represented by certificates and shall be held of

after the occurrence of the event, or within 30 days after the event has been discovered" take steps necessary to correct the breach.[123]

The close corporation subchapter empowers the court of chancery to appoint a custodian or provisional director for a close corporation whose directors (or shareholders, if the corporation is managed by shareholders instead of directors) are deadlocked to the extent the business is either suffering from, or threatened with, irreparable injury.[124] A provisional director may be appointed on the petition of one-half of the board, one-third of the voting shares,[125] or, when there is more than one voting class of stock, two-thirds of any such class.[126] A custodian, who has the power[127] to continue the corpo-

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record by not more than a specified number of persons, not exceeding 30; and

(2) All of the issued stock of all classes shall be subject to 1 or more of the restrictions on transfer permitted by § 202 of this title; and

(3) The corporation shall make no offering of any of its stock of any class which would constitute a "public offering" within the meaning of the United States Securities Act of 1933 . . . as it may be amended from time to time.

123. DEL. CODE ANN. tit. 8, § 348(a). The Delaware Court of Chancery, upon the suit of the corporation or any stockholder, shall have jurisdiction to issue all orders necessary to prevent the corporation from losing its status as a close corporation. The court may also restore its status as a close corporation by enjoining or setting aside any act or threatened act on the part of the corporation or a stockholder which would be inconsistent with any of the provisions or conditions required or permitted by section 342. *Id.* § 348(b).

124. DEL. CODE ANN. tit. 8, §§ 352, 353. *See generally* Giuricich v. Emtrol Corp., 449 A.2d 232, 237 n.11 (Del. 1982).

125. The court of chancery may, but is not required to appoint a custodian or receiver, as evidenced by the use of permissive word "may" rather than the mandatory "shall." *See* Pavlman v. Kritzer Radinut Coils, Inc., 143 A.2d 272 (Del. Ch. 1958).

126. DEL. CODE ANN. tit. 8, § 353(b). Even though the requirements of subsection (b) of this section relating to the number of directors or stockholders who may petition for appointment of a provisional director are not satisfied, the court of chancery may nevertheless appoint a provisional director if permitted by subsection (b) at § 352. *Id.* § 353(d). *See also id.* § 352(b).

127. DEL. CODE ANN. tit. 8, § 226(b). The statute provides in relevant part that:

> [a] custodian appointed under this section shall have all the powers and title of a receiver appointed under § 291 of this title, but the authority of the custodian is to continue the business of the corporation and not to liquidate its affairs and distribute its assets, except when the Court shall otherwise order and except in cases arising under paragraph (3) of subsection (a) of this section or paragraph (2) of subsection (a) of § 352 of this title.

ration's business, may be appointed upon application by any stockholder if proper grounds exist.[128]

Finally, the Delaware subchapter provides that a close corporation charter may include a provision granting to any shareholder, or to the holders of a specified number or percentage of shares of any class of stock, an option to have the corporation dissolved at will or upon the occurrence of a specified event or contingency.[129] The charter may be amended to include such provision by an affirmative vote of all the shareholders. The charter may specifically authorize such an amendment by a lower vote which cannot be less than two-thirds of the shares.[130]

III. ANALYSIS OF STATE CLOSE CORPORATION LAW

Section 35 of the Model Business Corporation Act (Model Act) states that the board of directors shall manage a corporation "except as may be otherwise provided in this Act or the articles of incorporation."[131] This provision allows shareholders to assume the functions normally exercised by directors and, read in conjunction with

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128. Under DEL. CODE ANN. tit. 8, § 226, proper grounds for the appointment of a custodian occur when:

> (1) At any meeting held for the election of directors the stockholders are so divided that they have failed to elect successors to directors whose terms have expired or would have expired upon qualification of their successors; or
>
> (2) The business of the corporation is suffering or is threatened with irreparable injury because the directors are so divided respecting the management of the affairs of the corporation that the required vote for action by the board of directors cannot be obtained and the stockholders are unable to terminate this division; or
>
> (3) The corporation has abandoned its business and has failed within a reasonable time to take steps to dissolve, liquidate or distribute its assets.

129. DEL. CODE ANN. tit. 8, § 355(a) (1983) states that:

> [w]henever any such option to dissolve is exercised, the stockholder exercising the option must give written notice of the dissolution to all other stockholders. After the expiration of 30 days following receipt of such notice, the dissolution of the corporation shall proceed as if the required number of stockholders having voting power had consented in writing to the dissolution of the corporation as provided by § 228.

See also id. § 228.

130. DEL. CODE ANN. tit. 8, § 355(b). This provision provides in pertinent part: "Each stock certificate in any corporation whose certificate authorizes dissolution must conspicuously note on its face the existence of the provision. Unless noted conspicuously on the face of the stock certificate, the provision is ineffective." *Id.* § 355(c).

131. Model Business Corp. Act Ann. 2d § 35, ¶ 1 (1969).

fourteen other provisions summarized in a special comment to section 35, makes the Model Act adaptable for the needs of a close corporation.[132]

On June 26,1982,[133] the American Bar Association's Committee on Corporate Laws adopted the Supplement which builds upon close corporation provisions in the Model Act. An introductory comment to a preliminary draft of the Supplement states that:

> [t]he main purpose of the Supplement is to provide model legislation for those states that wish to enact special provisions that incorporate the best available ideas on the special needs of close corporation shareholders and that at the same time provide basic statutory protection to the shareholders even in situations where they are not represented by experienced corporate counsel.[134]

Section 2(a) of the Supplement provides that the Model Act also applies to close corporations, to the extent that it is not inconsistent with the Supplement.[135] In the pages that follow, provisions in the Supplement are summarized and compared with Michigan and Delaware close corporation provisions.

A. Definition of a Statutory Close Corporation

Section 3 of the Supplement defines a close corporation as one "whose articles of incorporation contain a statement that the corporation is a statutory close corporation."[136] In addition, section 3 provides that "[a]ny corporation organized under the [general] business corporation act and having fewer than 50 shareholders may become a statutory close corporation by amending its articles of incorporation to include" a statement that the corporation is a "statutory close corporation."[137] The amendment must be approved by the holders of two-thirds of the shares of each class of stock of the corporation, whether they are normally voting shares or not.[138] Com-

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132. *Id.* ¶ 2.

133. *See Report of the Committee on Corporate Laws; Change in the Model Business Corporation Act,* 38 BUS. LAW. 1031 (1983).

134. Report of ABA Committee on Corporate Law, *Proposed Statutory Close Corporation Supplement to the Model Business Corporation Act,* 37 BUS. LAW. 269, 271 (1981) [hereinafter cited as *ABA Report*].

135. *See* Model Stat. Close Corp. Supp. § 2.

136. *Id.* § 3.

137. *Id.*

138. *Id.*

ment 1 to section 3 states that a new corporation can elect to become a statutory close corporation regardless of the number of shareholders as can an existing corporation with fewer than fifty shareholders; even if it subsequently has greater than fifty shareholders.[139] Section 3 further provides that any shareholder voting against a close corporation election "shall be entitled" to receive the fair value of his shares upon compliance with the provisions of the Model Act.[140]

The Delaware statute differs in its definition of close corporation status in that any close corporation, previously existing or newly formed, cannot have more than thirty shareholders.[141] A close corporation risks losing that status if its shares are subsequently held by more than thirty persons.[142] Delaware law, like the Supplement, requires that the entity's close corporation status be disclosed in the certificate of incorporation, and that any election of an existing corporation to become a close corporation be approved by the holders of "two-thirds of the shares of each class of stock of the corporation which are outstanding."[143] The Delaware statute allows a dissenting shareholder relief if the certificate of incorporation provides for appraisal rights or if an amendment to the certificate of incorporation provided for such rights is adopted. [144]

Michigan does not recognize a close corporation as a corporate form legally distinct from the general corporation form. Therefore, there is no requirement that disclosure of close corporation status be made in the articles of incorporation.[145] Nor are there limitations as to the number of shareholders.[146] Moreover, under the Act no shareholder election to be a close corporation is required.

The Supplement requires specific intent and positive shareholder action in order to terminate close corporation status.[147] Although an existing corporation electing to become a close corporation must have

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139. *Id.*

140. *Id.*

141. DEL. CODE ANN. tit. 8, § 342. The statute provides in relevant part that: "(1) All of the corporation's issued stock of all classes, exclusive of treasury shares shall be represented by certificates and shall be held of record by not more than a specified number of persons, not exceeding 30." *Id.* § 342(a)(1).

142. *Id.* § 345(2).

143. *Id.* § 344. *But see id.* § 349 (Stock restrictions are subject to the § 202 requirement of unanimity; otherwise appraisal rights are affected).

144. *Id.* § 262. *See generally* Kayne v. Pantone, Inc., 395 A.2d 369 (Del. Ch. 1978).

145. MICH. COMP. LAWS ANN. § 450.1202 (MICH. STAT. ANN. § 21.200(202)).

146. *Id.* § 450.1201 (MICH. STAT. ANN. § 21.200(201)).

147. *See* Model Stat. Close Corp. Supp. § 31.

fifty or fewer shareholders, later growth in the shareholder ranks does not cause a forfeiture of close corporation status.[148]

Because the Act does not recognize the close corporation as a distinct legal entity, it holds few pitfalls for the close corporation.[149] Delaware law contains pitfalls for the shareholders of a close corporation; e.g., close corporation status could be lost if the thirty shareholder limit is violated. [150] The close corporation subchapter does, however, contains several safety valves.[151]

B. Share Transfer Restrictions

The Supplement provides in section 11 that shares of a close corporation may not be transferred. [152] Section 11(b), however, lists a number of exceptions, such as transfer to a holder of the same class of shares, individual family members, and a trustee in bankruptcy.[153] Furthermore, section 12 establishes a procedure whereby shares can be transferred to a third party in a non-exempt transaction, so long as the corporation has been given the opportunity to purchase

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148. *Id.* § 3. The official comment to section 3 of the Supplement states that a new or existing corporation that becomes a statutory close corporation at a time when it has fewer than 50 shareholders can continue to operate as a statutory close corporation even though it subsequently has more than 50 shareholders. *Id.*

149. Nonetheless, it is possible that certain provisions normally beneficial to the close corporation, e.g., the provisions authorizing operation without a board of directors (MICH. COMP. LAWS ANN. § 450.1463 (MICH. STAT. ANN. § 21.200(463)), are no longer available. However, this discovery would occur only when the stock of the corporation becomes publicly traded, or is transferred without notice. *See also* MICH. COMP. LAWS ANN. § 450.1472(2) (MICH. STAT. ANN. § 21.200(472)(2)).

150. DEL. CODE ANN. tit. 8, § 345(b). *See also id.* § 342(a)(2), (3) (providing that transfer is subject to at least one of the restrictions in § 202 and prohibiting any offering which would constitute a "public offering").

151. *Id.* § 247(b) states that if the stock certificate contains notice of the 30 shareholder limit, any prospective shareholder who would become the 31st is conclusively presumed to be aware of that fact. Section 347(d) states that the corporation can refuse to register any transfer to such person. Section 348(a)(1) provides that a corporation may within 30 days after the occurrence of the violation, or within 30 days of the discovery of the violation, take steps to remedy any violations of the requirements for close corporation status without forfeiting that status. *Id.* § 348(a)(2). Also, a corporation or stockholder may file suit to obtain a court order to protect the close corporation status. *Id.* § 348(b). *See also supra* note 123 and accompanying text.

152. Model Stat. Close Corp. Supp. § 11.

153. *Id.* The exceptions for transfer are:

(1) to the corporation or to any other holder of the same class of shares;

(2) to members of the holder's immediate family (or to a trust, all

the shares on the same terms as the third party offer.[154] The Supplement's provisions concerning share transfer can be excluded or modified in the articles of incorporation.[155]

The Delaware subchapter requires the close corporation to make its shares subject to one or more specified transfer restrictions.[156] These include a corporation's right of first refusal, a provision obligating the corporation or a shareholder to purchase the stock of another shareholder on demand, and the right of the corporation or shareholders to consent to the transfer of shares to a new shareholder.[157] Delaware apparently views such restrictions as the best means of insuring the partnership-type rights of close corporation shareholders.

Michigan makes available to all corporations, the same types of transfer restrictions that Delaware makes mandatory for close corporations and optional for other corporations.[158] Although available

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of whose beneficiaries are members of the holder's immediate family) which consist of his spouse, parents, lineal descendants (including adopted children and stepchildren) and the spouse of any lineal descendant, and brothers and sisters;

(3) that has been approved in writing by all of the holders of the corporation's shares having voting rights;

(4) to an executor or administrator upon the death of a shareholder or to a trustee or receiver as the result of a bankruptcy, insolvency, dissolution, or similar proceeding brought by or against a shareholder;

(5) by merger or share exchange [under MBCA ch. 11] or a share exchange of existing shares for other shares of a different class or series in the corporation;

(6) by a pledge as collateral for a loan that does not grant the pledgee any voting rights possessed by the pledgor;

(7) made after termination of the corporation's status as a statutory close corporation.

Id. § 11(b)(1)-(7).

154. *Id.* § 12.

155. *Id.* § 11, comment 3.

156. DEL. CODE ANN. tit. 8, § 342(a)(2). *See also id.* § 202.

157. *Id.* at 202(c). Section 342 provides that all of the issued stock of all classes of a close corporation shall be subject to one or more of the restrictions on transfer permitted by section 202. *Id.* § 342(a)(2). Restrictions allowed under § 202 are binding only as to those shareholders who ratified them. *Id.* § 202(b). *See id.* § 349 (provision allowing for appraisal rights.).

158. MICH. COMP. LAWS ANN. § 450.1473 (MICH. STAT. ANN. § 21.200(473)). A restriction on the transfer of shares of a corporation is permitted if it:

(a) Obligates the holders of the restricted instruments to offer to the corporation or to any other holders of bonds or shares of the corporation or to any other person or to any combination thereof, a prior opportunity to acquire the restricted instruments.

to all corporations, Michigan's provisions are primarily intended for close corporations.

On the surface, it might appear that the approach used in Delaware and in the Supplement is preferable since transfer restrictions are built into the law. However, this approach is also dangerous because it might be viewed as a substitute for careful planning and bargaining when the corporation is formed. For example, as noted above, the Supplement allows transfers to a holder of the same class of shares. In many situations, such transfers can have the effect of upsetting a preexisting balance of power among the shareholders, often contrary to the expectations of minority shareholders.[159] Consequently, while the Supplement and Delaware law might be preferred in the absence of planning, the Act adequately serves the needs of incorporators who engage in the negotiation and bargaining that should take place at the inception of incorporation. The Act might have an added advantage in that it does not lull the incorporators into a false sense of security when negotiations take place.

C. Transfer of Shares in Breach of Transfer Restrictions

Section 10 of the Supplement requires that all stock certificates carry a notice which states:

> The rights of shareholders in a statutory close corporation may differ materially from the rights of shareholders in other corporations. Copies of the articles of incorporation and bylaws, shareholders' agreements, and other documents, any of which may restrict transfers and affect voting

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(b) Obligates the corporation or a holder of bonds or shares of the corporation or any other person or any combination thereof, to purchase the instruments which are the subject of an agreement respecting the purchase and sale of the restricted instruments.

(c) Requires the corporation or the holders of a class of bonds or shares of the corporation to consent to a proposed transfer of the restricted instruments or to approve the proposed transferee of the restricted instruments.

(d) Prohibits the transfer of the restricted instruments to designated persons or classes of persons, and the designation is not contrary to public policy.

(e) Exists for the purpose of maintaining the status of the corporation as an electing small business corporation under subchapter S of the United States Internal Revenue Code.

Id.

159. Mann, *A Critical Analysis of the Statutory Close Corporation Supplement to the Model Business Corporation Act*, 22 AM. BUS. L.J. 289, 304 (1984).

> and other rights, may be obtained by a shareholder on written request to the corporation.[160]

Section 13 of the Supplement provides that transfers in violation of restrictions which are binding on transferees shall be ineffective.[161] If a transfer in violation of a restriction not binding on a transferee (due either to lack of notice or invalidity of the restriction in question) is attempted, the corporation has the option, upon notice given within 30 days of presentment of the shares for registration, to purchase the shares from the transferee at the same price and terms agreed to by the transferee.[162]

In Delaware, when close corporation stock has been transferred to a person who has notice that transfer restrictions have been violated, the corporation may refuse to transfer the stock.[163] The court of chancery is empowered to enjoin or set aside transfers which violate the restrictions.[164] Even when a restriction is not authorized, the corporation has a thirty day option to acquire the restricted stock.[165]

The Act does not contain the remedies available in Delaware and under the Supplement. In the event that transfer restrictions are violated, the corporation has the power to rescind a transfer and remaining shareholders may have a cause of action for damages against the transferor.[166] It is unlikely, however, that even these remedies would be available in cases where the transfer restriction is held invalid, a situation in which both the Supplement and Delaware law provide a thirty day option to acquire the shares.[167]

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160. Model Stat. Close Corp. Supp. § 10.

161. *Id.* § 13(a).

162. *Id.* § 13(b).

163. DEL. CODE ANN. tit. 8, § 347(d). *See generally* Field, *Resolving Shareholder Disputes and Breaking Deadlocks in the Close Corporation*, 58 MINN. L. REV. 985, 1001 (1974).

164. DEL. CODE ANN. tit. 8, § 348(b). The statute provides in relevant part that:

> [t]he Court of Chancery may enjoin or set aside any transfer or threatened transfer of stock of a close corporation which is contrary to the terms of its certificate of incorporation or of any transfer restriction permitted by § 202 of this title, and may enjoin any public offering, as defined under § 342 of this title, or threatened public offering of stock of the close corporation.

165. *Id.* § 349. The corporation has the option to acquire the restricted security at a price which is agreed upon by the parties, or if no agreement is reached as to price, then at the fair value as determined by the court of chancery. *Id.*

166. MICH. COMP. LAWS § 450.1472(2) (MICH. STAT. ANN. § 21.200(472)(2)).

167. *See supra* note 165 and accompanying text.

D. Mergers, Consolidations, Share Exchanges, and Sale of Assets

Section 30(a) of the Supplement provides that any plan of merger, consolidation, or exchange of shares which would terminate the close corporation status of one of the corporations must be approved by the holders of two-thirds of the outstanding shares, whether otherwise entitled to vote or not.[168] Conversely, if one of the corporations in question would shift from a non-close corporation to a close corporation, the plan must be approved by the holders of two-thirds of the non-close corporation shares, whether or not otherwise entitled to vote.[169] This section merely emphasizes the requirement for election of close corporation status included in section 3, and the requirements for termination of close corporation status included in section 31. Section 30(b) provides that any sale, lease, or exchange of all or substantially all of the property and assets of a close corporation, if not made in the usual course of business, shall require the approval of the holders of two-thirds of the corporation's outstanding shares.[170]

Delaware's close corporation subchapter does not deal specifically with mergers. General Corporation Law provisions permit mergers, consolidations, and sales of assets upon approval of a simple majority.[171] Presumably, any merger that would result in loss of close corporation status would require a two-thirds approval of all voting and non-voting shares pursuant to the close corporation subchapter.[172]

Michigan permits approval of mergers and sales of substantially all assets by a simple majority, unless there is a provision in the articles requiring a higher vote.[173] Minority shareholders in Michigan remain free to bargain for increased protection and veto power in return for their contributions of capital or services to the corporation.

In a close corporation, much like a partnership, the argument can be made that fundamental changes in the business should require

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168. Model Stat. Close Corp. Supp. § 30(a)(1).

169. *Id.* § 30(a)(2).

170. *Id.* § 30(b).

171. DEL. CODE ANN. tit. 8, § 251(c). *See generally* Coleman v. Taub, 638 F.2d 628 (3d Cir. 1981).

172. DEL. CODE ANN. tit. 8, § 346(a). *See supra* note 121 and accompanying text.

173. MICH. COMP. LAWS ANN. §§ 450.1455, .1703, .1753(4) (MICH. STAT. ANN. §§ 21.200(455), .200(703), .200(753)(4)). The Act requires that notice of the meeting be given to each shareholder of record, not less than 20 days before the meeting. The notice must include a copy of summary of the plan of merger or consolidation and a statement informing shareholders of their right to dissent and be paid for the fair value of the shares. *Id.* § 21.200(703).

a unanimous, or at least higher than majority, vote. The Supplement's approach best achieves this goal.[174]

E. Termination of Close Corporation Status

Section 31 of the Supplement requires a two-thirds vote for termination of close corporation status.[175] Section 31 also requires the corporation to remove its description as a close corporation from the articles of incorporation, and elect a board of directors if it has none.[176] Additionally, dissenting shareholders are entitled to the fair value of their shares upon compliance with the applicable statutory provisions relating to rights of dissenting shareholders.[177] (The Supplement refers to sections 80 and 81 of the Model Act.)

Section 32 of the Supplement states that any corporation electing termination of close corporation status will be subject to the state's general business corporation act (or to the professional corporation act if organized thereunder).[178] Additionally, any rights of shareholders or the corporation under the articles of incorporation or a separate agreement will not be affected by the termination of close corporation status.[179] An exception is made to the extent that any agreements or any provisions within the articles of incorporation are invalid under the general business corporation act.[180] Finally, a corporation terminating its close corporation status is required to adopt bylaws, if it previously had none.[181]

Delaware law is similar to the Supplement except that it does not mention the rights of dissenting shareholders.[182] The Act, not recognizing close corporation status as being distinct from that of

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174. *See supra* notes 168-169 and accompanying text.
175. Model Stat. Close Corp. Supp. § 31(b).
176. *Id.* § 31(a).
177. *Id.* § 31(c). *See also* Rev. Model Business Corp. Act § 13.25.
178. Model Stat. Close Corp. Supp. § 32(a).
179. *Id.* § 31(b).
180. *Id.*
181. *Id.* § 22(b).
182. DEL. CODE ANN. tit. 8, § 346(a). The statute provides in relevant part that:

> [t]he certificate of incorporation of a close corporation may provide that on any amendment to terminate its status as a close corporation, a vote greater than two thirds or a vote of all shares of any class shall be required; and if the certificate of incorporation contains such a provision, that provision shall not be amended, repealed or modified by any vote less than that required to terminate the corporation's status as a close corporation.

other corporate entities, includes no provisions providing for the termination of close corporation status.

F. Election Not to Have a Board of Directors

Section 21 of the Supplement authorizes a close corporation to operate without a board of directors if the articles of incorporation so provide.[183] To include such a provision by an amendment to the articles requires a unanimous vote of all shareholders, subscribers, or incorporators,[184] whereas an amendment terminating the election requires only a two-thirds vote.[185] When an election to operate without a board of directors is made, the responsibilities and liabilities of the directors are placed upon the shareholders. Shareholder liability is limited to those entitled to vote on the action giving rise to such liability.[186]

The Delaware provision is essentially similar to its counterpart in the Supplement. Management by stockholders of a statutory close corporation must be approved by all incorporators and subscribers, or by all shareholders. The only difference between Delaware law and the Supplement is that the vote necessary to delete the provision is a simple majority.[187] Delaware law also permits a close corporation to operate as a partnership[188] and to make agreements to restrict the discretion of directors.[189]

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183. Model Stat. Close Corp. Supp. § 21(a).

184. *Id.* § 21(b).

185. *Id.* § 21(d). *See also supra* note 157 (interaction with § 202).

186. *Id.* § 21(c)(1), (3).

187. DEL. CODE ANN. tit. 8, § 351. The statute provides in relevant part that:

> [s]uch a provision may be inserted in the certificate of incorporation by amendment if all incorporators and subscribers or all holders of record of all of the outstanding stock, whether or not having voting power, authorize such a provision. An amendment to the certificate of incorporation to delete such a provision shall be adopted by a vote of the holders of a majority of all outstanding stock of the corporation, whether or not otherwise entitled to vote. If the certificate of incorporation contains a provision authorized by this section, the existence of such provision shall be noted conspicuously on the face or back of every stock certificate issued by such corporation.

188. *Id.* § 354. Section 354 provides that no written agreement among stockholders of a close corporation, nor any provision of the certificate of incorporation or of the bylaws of the corporation shall be invalid on the ground that it is an attempt by the parties to the agreement or by the stockholders of the corporation to treat the corporation as if it were a partnership. *Id.*

189. *Id.* § 350. *See generally* Chapin v. Benwood Found., Inc., 402 A.2d 1205 (Del. Ch. 1979), *aff'd sub nom.*, Harrison v. Chapin, 415 A.2d 1068 (Del. 1980).

The Act allows a corporation to operate without a board of directors if such a provision is included within the articles of incorporation. The enabling language in the Act provides that "[t]he business and affairs of a corporation shall be managed by or under the direction of its board, except as otherwise provided in this act or in its articles of incorporation."[190] This basic enabling provision must be read in tandem with the section validating agreements concerning internal management.[191] The election must be unanimously approved, and has the effect of placing the directors' powers and liabilities upon the shareholders. The shareholders may delegate the management function to one or more of the shareholders or other persons.[192] The persons to whom the powers are delegated must be identified in the articles, and the existence of the provision must be noted on every stock certificate.[193] The election may be terminated by a simple majority pursuant to the Act's procedure for amendment of the articles, or by a higher vote if required by the articles of incorporation.[194]

Michigan's internal management section specifies two situations where the election not to have a board, as well as an agreement limiting the directors' discretion, becomes invalid.[195] These situations occur when there is a transfer or issuance to a person without notice of the election's existence and when there is public trading of the shares on a national securities exchange or the over-the-counter market.[196] The Act contains no specific directives for election of a board should one of these events occur.

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190. MICH. COMP. LAWS ANN. § 450.1501 (MICH. STAT. ANN. § 21.200(501)). Despite this enabling provision, establishing a corporation without a board can result in complications—for example, when a bank requires a directors' resolution to open a bank account.

191. MICH. COMP. LAWS ANN. § 450.1463 (MICH. STAT. ANN. § 21.200(463)). The statute provides in relevant part that a provision in the articles of incorporation may provide that:

> [t]here shall not be a board of directors, or may restrict the board in its management of the business of the corporation or may delegate to 1 or more shareholders or other persons, a part of the management otherwise within the authority of the board, if all the incorporators have authorized the provision in the articles or the holders of all outstanding shares have authorized the provision in an amendment to the articles.

192. *Id.*

193. *Id.*

194. MICH. COMP. LAWS ANN. § 450.1611 (MICH. STAT. ANN. § 21.200(611)). *See generally* Detroit & Canada Tunnel Corp. v. Martin, 353 Mich. 219, 91 N.W.2d 525 (1958).

195. *See infra* notes 79-86 and accompanying text.

196. MICH. COMP. LAWS ANN. § 450.1463(2) (MICH. STAT. ANN. § 21.200(463)(2)).

All of these statutes ratify the general concept that shareholders in a close corporation may act as though they have the rights of general partners in a partnership if they so desire. The statutory procedures involved in an election to operate without a board of directors vary somewhat among the statutes. Both the Supplement and Delaware law have a precondition that the corporation elect statutory close corporation status, even though the general business corporation sections of these statutes seem to permit similar arrangements for any corporation. When compared with the Act, this appears unduly complex.

G. Agreements Among Shareholders

Section 20 of the Supplement authorizes shareholder agreements to regulate the exercise of corporate powers, management of the business, and relations among shareholders.[197] Such agreements must be in writing and require the unanimous consent of the shareholders. Thus, section 20 recognizes that shareholders may elect to operate the corporation as if it were a partnership, and specifically authorizes such an approach to doing business.[198] In addition, this section recognizes that shareholders may either eliminate the board of directors (pursuant to section 21) or restrict the discretion or powers of the board. [199] When the corporation has a board of directors whose discretion is restricted by a shareholder agreement shifting certain corporate responsibilities from the directors to the shareholders, the Supplement provides that any liability flowing from acts or omissions normally related to those director responsibilities also shifts to the shareholders.[200]

Section 20 requires disclosure in the articles of incorporation of any election not to have a board of directors.[201] Pursuant to section 20(e), a shareholder's right to compel dissolution of the corporation (as authorized in section 15) must also be set forth in the articles of incorporation.[202] Section 20(f) states that any amendment to a shareholder agreement authorized by this section must be made by unanimous consent of the shareholders, just as unanimous consent is necessary to reach such an agreement.[203] Section 20 recognizes

197. Model Stat. Close Corp. Supp. § 20(a).
198. *See id.* § 20(b)(3).
199. *See id.* § 20(c) (discussing procedure in abolishing the board of directors pursuant to § 21).
200. *See id.* (imposition of liability pursuant to agreement).
201. *Id.* § 20(d).
202. *Id.* § 20(e).
203. *Id.* § 20(f).

that subscribers to shares of the corporation are authorized to make any agreement shareholders are authorized to make, if the shares of the corporation have not yet been issued. [204] Finally, section 20 recognizes that any other agreements, not otherwise prohibited by law, can be made between two or more shareholders.[205]

Delaware law includes a provision somewhat analogous to section 20 of the Supplement. Under Delaware law, a majority of the stockholders can enter into an agreement which will not be held invalid on the ground that its performance interferes with or restricts the discretion or powers of the board of directors.[206] Those who are parties to the agreement assume liability for any acts or omissions occurring as a result of the agreement.[207] In comparison, the Supplement requires *unanimous* consent of the shareholders to make an agreement as authorized by section 20, and makes *all* shareholders liable for any resulting act or omission.[208]

The Supplement includes within its section pertaining to shareholder agreements recognition that shareholders may elect to operate the close corporation as a partnership.[209] Delaware includes a separate section recognizing the shareholder's right to this election.[210] The Delaware provision specifically authorizes the close corporation to operate using both the management structure and organizational practices found only in a partnership.[211]

While the Supplement specifically requires unanimous consent to amend any section 20 agreement among shareholders,[212] Delaware law makes no mention of requirements to amend shareholder agreements. However, since the Delaware statute requires only a majority vote to institute such an agreement, a majority vote is implicitly sufficient to amend the agreement.

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204. *Id.* § 20(g).
205. *Id.* § 20(h).
206. DEL. CODE. ANN. tit. 8, § 350 provides in relevant part:

> A written agreement among the stockholders of a close corporation holding a majority of the outstanding stock entitled to vote, whether solely among themselves or with a party not a stockholder, is not invalid, as between the parties to the agreement, on the ground that it so relates to the conduct of the business and affairs of the corporation as to restrict or interfere with the discretion or powers of the board of directors.

207. *Id.*
208. Model Stat. Close Corp. Supp. § 20.
209. *Id.*
210. *See infra* note 211 and accompanying text.
211. DEL. CODE ANN. tit. 8, § 354.
212. Model Stat. Close Supp. § 20(f).

The Act authorizes not only elimination of the board of directors, should the shareholders so elect, but also any restriction on the discretion and powers of the board (should one be in existence) if agreed to by *all* stockholders.[213] Such agreements may be amended or deleted by a simple majority, and minority dissenters may have appraisal rights.[214] The agreement must be included in the articles.[215]

Michigan, unlike Delaware and the Supplement, does not explicitly recognize the right of stockholders to operate a close corporation as a partnership. This is undoubtedly due to the fact that the Michigan statutory provisions applicable to close corporations are available to corporations of any size and with any number of shareholders.

Both Michigan and Delaware have promulgated a provision authorizing a corporation to grant a shareholder or shareholders the right to require dissolution.[216] Although these sections may be compared to section 33 of the Supplement, it should be noted that both these statutes, like the Supplement's section 20, require that any such provision be disclosed within the certificate of incorporation.[217]

The Supplement and the Act are preferable in their requirement of unanimous approval of management agreements.[218] The impact of such agreements was noted by the drafters of the Supplement: "The requirement of unanimity for adoption and amendment is based on the unusual nature of an agreement that so radically alters the normal corporate structure."[219] While the Act does allow amend-

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213. MICH. COMP. LAWS § 450.1463 (MICH. STAT. ANN. § 21.200(463)).

214. *Id.* § 450.1621 (MICH. STAT. ANN. § 21.200(621)). In Michigan, a shareholder owns stock subject to an implied provision contained in corporation laws permitting amendment of the articles by a shareholder majority. R. SCHMIDT & Z. CAVITCH, *supra* note 36, § 13.21(2).

215. MICH. COMP. LAWS § 450.1463(1) (MICH. STAT. ANN. § 21.200(463)(1)).

216. *Id.* § 450.1805 (MICH. STAT. ANN. § 21.200(805)).

If the articles contain this provision, dissolution may be effected by filing a certificate of dissolution authorized by the number of shareholders set out in the provision. The comment to the statute indicates the purpose of this provision is to permit consent dissolution on deadlock or other event in the case of a close corporation. *Id. See* DEL. CODE ANN. tit. 8, § 355(a) which provides:

> The certificate of incorporation of any close corporation may include a provision granting to any stockholder, or to the holders of any specified number or percentage of shares of any class of stock, an option to have the corporation dissolved at will or upon the occurrence of any specified event or contingency.

217. *Id.*

218. *See supra* note 28 (text of § 21.200(463)).

219. MODEL STAT. CLOSE CORP. SUPP. § 20, official comment.

ment or deletion of the agreement by majority rule, dissenters at least may have certain appraisal rights. It may be argued that the Michigan provision, requiring that the agreement appear in the articles, is unnecessary. This provision, for instance, would necessitate modification of the articles whenever the shareholders desire to change an agreement. The provision, however, may be beneficial in providing notice to potential investors of the terms of an agreement.

H. Bylaws

Section 22 of the Supplement provides that "[a] statutory close corporation need not adopt bylaws if provisions required by law to be contained in bylaws are contained in either articles of incorporation or a shareholder agreement . . . ."[220] The Supplement forgoes a bylaw requirement in an attempt to recognize the fact that many close corporations choose to operate in a manner similar to that of a partnership. Furthermore, the Supplement recognizes that "business corporation statutes universally require that a corporation adopt bylaws."[221] However, the commentators noted that these statutes specify very few provisions that must be included in the bylaws.[222] While most business corporation statutes apparently require that a corporation adopt bylaws, it appears that bylaws may not be necessary in Delaware. Section 102 of the Delaware statute provides that: "Any provision which is required or permitted by any section of this chapter to be stated in the by-laws [sic] may instead be stated in the certificate of incorporation."[223] While this language does not explicitly state that in such cases corporate bylaws are not required, bylaws would be rather hollow if all required provisions were in fact stated elsewhere as authorized by this provision. Therefore, there is apparently no explicit requirement in the Delaware General Corporation Law that a corporation adopt bylaws.[224]

Whether Michigan requires bylaws is unclear. The Act provides that "[t]he articles of incorporation may contain any provision not

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220. *Id.* § 22.
221. *Id.* § 22, official comment.
222. *Id.*
223. DEL. CODE ANN. tit. 8, § 102(b)(1).
224. *Id.* Section 108 makes mention of a meeting, one purpose of which is to adopt bylaws. Section 107 refers to the adoption of bylaws as something which is "necessary and proper to perfect the organization of the corporation." While this language assumes that bylaws will be adopted, it apparently is no mandate that they must, especially read in conjunction with § 102(b)(1) of the Delaware Code.

inconsistent with this act or any other statute of this state . . . including any provision which under this act is required or permitted to be set forth in the bylaws."[225] The Act allows provisions otherwise required to be included in the bylaws also to be included in the articles of incorporation. However, it does not allow the articles of incorporation to serve as a substitute for bylaws.[226]

The Act should be amended to provide that bylaws are not required. As the comment to section 12 of the Supplement suggests, in a close corporation where investors are active in the business, a shareholders' agreement often includes the information normally contained in the bylaws. Requiring bylaws involves unnecessary duplication and a formalism that may be burdensome in close corporations, which are typically operated on a more informal basis than larger companies.[227]

I. Annual Meeting

Section 23 of the Supplement authorizes a close corporation to establish a date at which an annual meeting may be held, by way of articles of incorporation, bylaws, or shareholder agreements as authorized by section 20.[228] If no annual meeting date is so established, the date shall be the first business day after May 31. [229] However, unless a contrary provision is made in the articles of incorporation, no annual meeting need be held unless a written

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225. MICH. COMP. LAWS § 450.1209 (MICH. STAT. ANN. § 21.200(209)).

226. *Id.* § 450.1231 (MICH. STAT. ANN. § 21.200(231) provides:

> The initial bylaws of a corporation shall be adopted by its incorporators, its shareholders or its board. The shareholders or the board may amend or repeal the bylaws or adopt new bylaws unless power to do so is reserved exclusively to the shareholders by the articles of incorporation. The shareholders may prescribe in the bylaws that any bylaw made by them shall not be altered or repealed by the board. The bylaws may contain any provision for the regulation and management of the affairs of the corporation not inconsistent with law or the articles of incorporation.

This language may be interpreted to serve as identification of the parties charged with the authority to adopt initial bylaws rather than to operate as a requirement that bylaws be adopted. It might be argued that there is little difference between the express power to adopt and repeal bylaws and the power never to adopt bylaws at all.

227. *See* MODEL STAT. CLOSE CORP. SUPP. § 22. Because the Act is not integrated, the proposed amendment would apply to all corporations. It is unlikely, however, that large, publicly-held corporations would elect to operate without bylaws.

228. *Id.* § 23(a).

229. *Id.*

request is delivered to the corporation by a shareholder, thirty or more days prior to the established meeting date.[230]

In comparison, the Delaware statute states: "An annual meeting of stockholders shall be held for the election of directors on a date and at a time designated by or in the manner provided in the bylaws . . . ."[231] While this provision is applicable to close corporations, it would obviously have little effect on a close corporation with no board of directors and no bylaws. If the directors (or shareholders, where no board of directors exists) fail to hold a meeting within thirty days of the date designated, or if no date has been designated for a period of thirteen months from the date of incorporation or the last annual meeting, the court of chancery may, upon the application of any shareholder or director, summarily order that a meeting be held.[232] Failure to hold an annual meeting, however, does not invalidate otherwise valid corporate acts or operate as a forfeiture or dissolution of the corporation.[233] Furthermore, Delaware law provides that corporate action may be taken without a meeting (on written agreement of the incorporators, directors, or shareholders) if that action would have been permitted at the organizational meeting.[234] Therefore, it appears that a close corporation may operate in Delaware without ever conducting an annual meeting.

The Michigan statute provides: "An annual meeting of shareholders for election of directors and for such other business as may come before the meeting shall be held at a time as provided in the bylaws, unless such action is taken by written consent as provided in section 407."[235] If the corporation elects to operate without a

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230. *Id.* § 23(2).

231. DEL. CODE ANN. tit. 8, § 211(b). *See also* Coaxial Communications, Inc. v. CNA Fin. Corp., 367 A.2d 994 (Del. 1976) (alternative procedures are provided to assure that there is corporate compliance).

232. *Id.* § 211(c). *See* Savin Business Machs. Corp. v. Rapifax Corp., 375 A.2d 469 (Del. Ch. 1977) (use of term "may summarily order" in subsection (c) grants the court discretion); Tweedy, Browne & Knapp v. Cambridge Fund, Inc., 318 A.2d 635 (Del. Ch. 1974) (court has duty to make sure meeting and election takes place as per spirit of subsection (c)). *See generally* Walsh, *Delaware Statutory Provisions and Case-Law Applicable to Director and Shareholders Meetings,* 3 DEL. J. CORP. L. 182 (1978) (a discussion of the applicability of § 211).

233. *See* DEL. CODE ANN. tit. 8, § 211(c).

234. *Id.* §§ 108(c), 228(a).

235. MICH. COMP. LAWS § 450.1401 (MICH. STAT. ANN. § 21.200(402)).

Section 407 requires that the articles of incorporation may provide for action to be taken without a meeting, if there is written consent setting forth the action to be taken and signed by the requisite number of shareholders. *Id.* § 21.200(407).

board of directors, there would be little reason to hold an annual meeting unless "other business" arises which requires an annual meeting. Additionally, Michigan, like Delaware, allows a corporation to take action without a meeting, provided that written consent of a sufficient number of shareholders to authorize such action is obtained. [236]

The Act's "requirement" of an annual meeting, like the Delaware statute, provides that "[f]ailure to hold the annual meeting at the designated time . . . does not affect otherwise valid corporate acts or work a forfeiture or give cause for dissolution . . . ."[237] Therefore, there is no immediate penalty for failure to hold an annual meeting. Like Delaware, the Act provides that the circuit court may summarily order that a meeting be held upon the application of a shareholder. Michigan has established slightly different requirements than Delaware regarding passage of time before a circuit court will take action on a shareholder's application for a meeting. The prerequisites for compelling a shareholder's meeting under the Act are the passage of ninety days (rather than thirty) after the date designated for the annual meeting, or fifteen months (rather than thirteen) after organization of the corporation or the holding of the last annual meeting.[238]

It appears that Michigan, like Delaware, will not require an annual meeting, unless a shareholder wishes to compel one. However, in failing to make clear that an annual meeting is not necessary, Delaware and Michigan do not expressly recognize the special situation of close corporations, i.e., often operating as incorporated partnerships. Rather, one must "read around" the state statutes to reach the result expressly authorized by the Supplement. Despite statutory provisions to the contrary, the failure to hold meetings could be raised in an attempt to pierce the corporate veil. The Supplement reduces unnecessary corporate formality without endangering the separate identity of the corporation.

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236. *Id.* § 450.1407 (MICH. STAT. ANN. § 21.200(407)).

237. *Id.* § 450.1402 (MICH. STAT. ANN. § 21.200(402)).

238. *Id.* Although a federal court in Studebaker Corp. v. Allied Products Corp., 256 F. Supp. 173, 189 (W.D. Mich. 1966), concluded that, under Michigan law, an annual meeting is implicitly required, the case was decided prior to the promulgation of the Business Corporation Act. Therefore, the court did not have the opportunity to address the rights and responsibilities of close corporations under the present Michigan law. Additionally, the court's conclusion may be considered dictum.

J. Shareholder Sale Option at Death

Sections 14 through 17 of the Supplement authorize a compulsory buy-out upon the death of a shareholder. If the articles of incorporation so provide, an executor or administrator is given the right to require the corporation either to redeem all (but not less than all) of the decedent's shares, or be dissolved. [239] The buy-out provisions authorized by section 14 can be modified by two-thirds vote of all shares,[240] and a shareholder who votes against alteration of buy-out rights has the right to obtain the fair value of his shares.[241] Sections 15 through 17 set forth in detail the procedure by which the buy-out option is exercised.

Delaware law includes no provision analogous to sections 14 through 17 of the Supplement. However, a Delaware close corporation is free to adopt a buy-out provision similar to that provided in the Supplement.[242] The same option is available under the Act.[243]

The difference between the Supplement on the one hand, and the Delaware and Michigan statutes on the other, is the specific tailoring of the Supplement to the assumed needs of a "typical" close corporation. The Supplement establishes a procedure which may be adopted by the incorporators through reference in the articles of incorporation.[244] Additionally, the Supplement's procedure is easily modified to fit the needs of a particular close corporation. The articles of incorporation need only state that sections 14 through 17 of the Supplement have been adopted with changes as specified in the articles.[245] Delaware and Michigan, however, require that the incorporators draft and adopt a buy-out provision. While the procedure specified in the Supplement would be valid in both Delaware and Michigan, it is clearly more difficult for a close corporation to provide for such a buy-out. In either state detailed language must be drafted and formally adopted.

Given the importance of liquidity for the shares of a decedent and the potential for litigation resulting from liquidity problems, the Supplement is preferable. It provides both protection to shareholders

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239. Model Stat. Close Corp. Supp. § 14(a).

240. *Id.* § 14(c).

241. *Id.* § 14(d). The shareholder who votes against the amendment is entitled to dissenters' rights under Model Business Corporation Act, Chapter 13.

242. DEL. CODE ANN. tit. 8, § 347.

243. MICH. COMP. LAWS § 450.1473 (MICH. STAT. ANN. § 21.200(473)).

244. Model Stat. Close Corp. Supp. § 14.

245. *Id.* § 14, official comment.

who have no buy-out agreement and the basis for an agreement when one is desirable. Incorporators and their attorneys must recognize, however, that business and personal considerations, such as tax implications,[246] vary among close corporations. Therefore, in dealing with share transfer restrictions, wholesale adoption of a statutory buy-out provision should never supplant careful negotiation and planning when a business is formed.

K. Shareholder Option to Dissolve the Corporation

Section 33(a) of the Supplement provides in part that "[t]he articles of incorporation of a statutory close corporation may authorize one or more shareholders, or the holders of a specified number or percentage of shares of any class or series, to dissolve the corporation at will or upon the occurrence of a specified event or contingency."[247] Shareholders desiring to exercise any right authorized by section 33 are required to give written notice to all other shareholders.[248] Thirty-one days after such notice is effective, dissolution proceeds as provided in the Model Act.[249]

The Supplement further provides in section 33(b) that:

> [u]nless the articles of incorporation provide otherwise, an amendment to the articles of incorporation to add, change or delete the authority to dissolve described in subsection (a) must be approved by the holders of all the outstanding shares, whether or not otherwise entitled to vote on amendments, or if no shares have been issued, by all the subscribers for shares, if any, or if none, by all the incorporators.[250]

The corresponding comment states that the section is intended to give the shareholders of a close corporation "the same power to dissolve the business as general partners have under the Uniform Partnership Act."[251] Section 33 of the Supplement is similar to the Delaware statute granting to shareholders a right to compel disso-

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246. *Id.* § 14.

247. *Id.* § 33(a). This section is patterned after the Delaware statute. *Id.*, official comment.

248. *Id.*

249. *Id.* (dissolution proceedings). *See also* MBCA §§ 14.03-.07.

250. *Id.* § 33(b).

251. *Id.*, official comment.

lution in special circumstances, or at will.[252] The Michigan statute also contains similar provisions which are available to all corporations.[253]

L. Power of Court to Grant Relief in Certain Circumstances

Sections 40 through 43 of the Supplement spell out various circumstances from which a shareholder may seek judicial relief.[254] The range of relief is clearly enumerated.[255]

One of the major concerns of a shareholder in a close corporation is the ability to exercise influence over corporate operations and management decisions.[256] This is generally of greater concern to a shareholder in a close corporation than it is to the holder of shares in a publicly traded corporation since the option to sell the shares for a fair price is limited by a lack of marketability.[257] When the close corporation shareholder is no longer heard by the other shareholders or corporate management, the Supplement remedies may be available.[258] The Supplement provides relief when:

(1) those in control of the corporation have acted (or will act) "in a manner that is illegal, oppressive, fraudulent, or unfairly prejudicial";

(2) those in control are deadlocked, and thereby unable to manage effectively or run the close corporation; and

(3) there exists one or more grounds for judicial dissolution under the Model Act.[259]

Upon petition, a shareholder in a statutory close corporation may be granted whatever relief the court deems appropriate.[260] Several remedies are specified and a court may order one or more types of relief.[261]

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252. DEL. CODE ANN. tit. 8, § 355. The authorizing provision must be included in the articles of incorporation.

253. MICH. COMP. LAWS § 450.1805 (MICH. STAT. ANN. § 21.200(805)).

254. *See* Model Stat. Close Corp. Supp. §§ 40-43. No relief of any kind may be ordered unless the court affirmatively finds that one or more of the specific conditions listed in § 40(a)—fraud, oppression, unfairly prejudicial conduct, deadlock, or grounds for involutary dissolution—exist. *Id.* § 40(a).

255. *Id.*

256. H. HENN & J. ALEXANDER, *supra* note 2, § 257.

257. *Id.*

258. *See supra* note 254.

259. Model Stat. Close Corp. Supp. § 40(a).

260. *See id.* §§ 41, 42, 43 (specifying relief available under the statute).

261. *Id.* § 40(3) (provides that the remedies available under the Supplement are in addition to any right or remedy).

The Delaware close corporation statute provides for court-ordered dissolution of a corporation. For instance, when the petitioner can show that the corporation is insolvent, a failure of corporate purpose, or an imminent danger of great loss resulting from an irreparable division of the board of directors, a dissolution may be ordered.[262] When such a situation arises, the Delaware courts are not restricted to the dissolution remedy; the court may, in its discretion, appoint a provisional director or custodian to continue the business of the corporation.[263] Although Delaware does not specifically authorize other alternative remedies, a court presumably could use traditional equitable remedies.

Under the Act, the list of specifically approved remedies fails to include several of those listed in the Supplement. For example, the provisions do not provide for the appointment of a custodian, appointment of a provisional director, or an order to pay dividends.[264] The list of suggested remedies in Michigan is designed to encourage the courts to impose relief short of liquidation and dissolution in circumstances where dissolution is too harsh a remedy.[265] Courts are not limited to the relief included in the list. Although the drafters did not include the additional remedies suggested by the Supplement, there is no indication that their omission was made with the purpose of discouraging their application. Both the Act and the Supplement specifically give courts the power to grant such relief other than dissolution if deemed appropriate.[266] The Michigan Court of Appeals, however, has shown reluctance to provide relief which is less drastic than dissolution.[267]

A choice between Delaware law, the Supplement, and the Act depends on the desirability of increasing the influence of courts in the administration of private business associations. Courts in most jurisdictions defer to two pervasive principles of corporation law: the business judgment rule and the principle of majority rule. Courts do not like to supplant the judgment of the owners of a corporation

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262. DEL. CODE ANN. tit. 8, §§ 226, 352 (providing for the appointment of custodian or receiver of corporation and close corporation, respectively).

263. *Id.* § 353.

264. *See* MICH. COMP. LAWS § 450.1825 (MICH. STAT. ANN. § 21.200(825)).

265. *Id.*

266. *Id.* § 825(2).

267. S. SIEGEL, *supra* note 37, § 8.06 (citing Barnett v. International Tennis Corp., 80 Mich. App. 396, 263 N.W.2d 908 (1978)); *but see* Moore v. Carney, 84 Mich. App. 399, 269 N.W.2d 614 (1978).

with their own decisions unless a clear case of fraud or oppression is demonstrated.[268] Perhaps the reluctance of courts to interfere is justified given the complexity of business decisions and the difficulty a judge faces in becoming familiar with the operative facts when a corporation has internal management disputes. It should also be noted that courts refuse to award specific performance as a remedy for breach of a personal service contract. Since most of the problems confronting small corporations are personal conflicts—disagreements over management strategy and power struggles between different factions or individuals—specific performance is inadequate. Perhaps these situations are better left to resolve themselves than to be realigned in a court battle which depletes the finances of the parties and exacerbates existing animosity.

However, the argument can also be made that corporation law is designed to deter certain conduct and to protect the rights of minority shareholders. In a close corporation, a majority shareholder or a group of shareholders owning a majority of the corporation's stock can easily squeeze out a minority shareholder. Such conduct deprives the minority shareholder of a financial interest in the corporation, as well as the right to participate in the management of the corporation. These interests are too important to go unprotected. Therefore, it would appear that courts should be given the express power to act in order to protect minority interests. Considering this rationale, the Supplement and the Act are preferable because they provide the courts with greater express power than the Delaware statute. However, the differences between the Michigan and Delaware statutes might be greater in theory than in practice, given the reluctance of Michigan courts to provide relief.[269]

M. Limited Liability

Section 25 of the Supplement states: "The failure of a statutory close corporation to observe the usual corporate formalities or requirements relating to the exercise of its corporate powers or the management of its business and affairs shall not be grounds for imposing personal liability on the shareholders for liabilities of the corporation."[270] The comment to this section notes that its purpose is to make certain that, even if the shareholders elect to operate the

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268. *See* Model Stat. Close Corp. Supp. § 40, official comment. *See generally* Pease, Aronson v. Lewis: *When Demand is Excused and Delaware's Business Judgment Rule,* 9 DEL. J. CORP. L. 39 (1984).

269. *See supra* note 267 and accompanying text.

270. Model Stat. Close Corp. Supp. § 25.

close corporation like a partnership, it is still a legally constituted corporation with the limited liability attendant to such entities.[271]

Delaware law specifically provides for operating a close corporation like a partnership.[272] Delaware law does not expressly state that, by electing to operate the corporation as a partnership, the limited liability attaching to the corporate form is not placed in jeopardy. However, it appears to be the intent of the statute's drafters that the benefits of the corporate form apply to a close corporation, regardless of any election by the shareholders to treat it as a partnership.

Michigan has no provision similar to section 25. On one hand, it can be argued that such a provision is unnecessary because Michigan does not provide for statutory close corporations and a close corporation that adheres to the requirements of the Act presumably would not be in danger of having its corporate veil pierced. On the other hand, a Michigan corporation may operate without a board of directors (or might be subject to a management agreement which limits the board's discretion) and may elect to give shareholders the right to dissolve the corporation at will or upon the occurrence of specified events.[273] While these features should not cause a court to pierce the corporate veil, a provision similar to section 25 would certainly do no harm.

N. Execution of Documents

Section 24 of the Supplement permits a person who holds more than one office in a statutory close corporation to execute, acknowledge, or verify any instrument in more than one capacity.[274] Such authority is given even if the instrument is required by law to be officially signed by two or more different corporate officers.[275] This section is particularly useful in helping one-person corporations avoid filing formalities.

Delaware's close corporation subchapter contains no special provision on execution of documents. Section 142(a) of the Delaware General Corporation Law permits any number of offices to be held by the same person.[276] This provision does not reject the possibility of an officer executing documents in more than one capacity, and

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271. *Id.*, official comment.
272. DEL. CODE ANN. tit. 8, § 354.
273. *See supra* notes 28 (text of § 450.1463) and 253.
274. Model Stat. Close Corp. Supp. § 124.
275. *Id. See* Model Stat. Close Corp. Supp. § 24.
276. DEL. CODE ANN. tit. 8, § 142(a).

another section provides for the execution of corporate documents when there are no officers.[277]

Although the Act permits one person to hold two or more offices, unlike the Supplement it does not allow a person to execute documents in more than one official capacity.[278] The Act also requires two official signatures when stock certificates are issued[279] and the articles may similarly require dual signatures.[280] Such an approach is unduly restrictive in close corporations where, as is often the case, there is only one shareholder or officer.

IV. CONCLUSION

Four questions are especially relevant in evaluating a close corporation law:[281] (1) Is the law flexible in allowing corporations to vary usual corporate rules to meet special needs of shareholders? (2) Does the law minimize legal formalities? (3) Are minority shareholders protected from oppression? (4) Should close corporation provisions be adopted in a separate chapter or included among the provisions of the general corporation act? The corporation statutes may be evaluated in light of these inquiries.

A. Flexibility

Close corporation shareholders need maximum flexibility to meet their particular business and personal needs.[282] "At any given moment in time there are literally thousands of close corporations that fall all along a spectrum of one-owner mom and pop operations to gigantic subsidiaries of major public corporations."[283] Flexibility thus becomes a major concern.

The Supplement contains a number of provisions designed to meet special shareholder needs. Both the standard share transfer restrictions and the buy-out provisions can be modified to meet

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277. *Id.* § 103(a)(2). However, an attesting signature is required if there are officers. *But see id.* § 158 (two signatures by officers are required on the certificate).

278. MICH. COMP. LAWS § 450.1531(2) (MICH. STAT. ANN. § 21.200(531)(2)).

279. *Id.* § 450.1331 (MICH. STAT. ANN. § 21.200(331)) (facsimile signatures are allowed).

280. *Id.* §§ 450.1201, .1231 (MICH. STAT. ANN. §§ 21.200(201), (231)).

281. These questions were derived from the guiding principles used in drafting the Model Stat. Close Corp. Supp., *ABA Report*, *supra* note 134, at 271.

282. *See* Model Stat. Close Corp. Supp., Introductory Comment.

283. *ABA Report*, *supra* note 134, at 272.

particular shareholder needs.[284] Furthermore, the articles of incorporation may provide shareholders with the option to dissolve the corporation, and shareholders have available other remedies that may be used to resolve shareholder disputes.[285]

Delaware law provides essentially the same flexibility as the Supplement, with two exceptions. First, the Delaware law regarding share transfer restrictions is less flexible; a Delaware close corporation must make its shares subject to one or more specified transfer restrictions.[286] Second, although Delaware law does not specifically authorize the wide range of remedies available in the Supplement to resolve shareholder disputes, presumably Delaware courts can utilize traditional equitable remedies.[287]

In comparison, the Act provides the same flexibility as the Supplement. However, while Michigan law provides a wide range of remedies to resolve shareholder disputes, in practice there has been hesitancy to apply the remedies unless dissolution is warranted.[288]

An argument can be advanced that the laws in Michigan and Delaware are too flexible in comparison with the Supplement. While both states allow close corporations the freedom to draft a buy-out provision,[289] they provide no ready-made statutory provision. The Supplement's buy-out provision may be adopted by reference and may significantly reduce the time and problems associated with drafting such a provision de novo. Thus, the Supplement simplifies the incorporation process.[290] In practice, however, the Supplement's buy-out provision may have to be tailored to meet specific needs.

B. Legal Formalities

A specific type of flexibility—the opportunity to operate a business with minimal legal formality—is especially important in the close corporation setting. The Supplement provides a number of features

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284. *See* Model Stat. Close Corp. Supp. § 11.

285. *Id.* § 33 (right to dissolution).

286. *See supra* notes 156-157 and accompanying text.

287. *See supra* notes 262-263 and accompanying text.

288. *See supra* note 267 and accompanying text.

289. *See supra* notes 242-243 and accompanying text. *Cf.* Grynberg v. Burke, 378 A.2d 139 (Del. Ch. 1977) (corporation's right to first approve a transfer of its stock is permissible if it bears some reasonable relation to best interests of corporation); Fletcher v. Kentucky Inns, Inc., 88 Mich. App. 456, 276 N.W.2d 619 (1979).

290. *See supra* notes 244-245 and accompanying text.

which allow informal operations: a close corporation may operate without a board of directors;[291] as a partnership;[292] bylaws need not be required;[293] and, unless shareholders demand, an annual meeting need not be held. [294]

The law in Delaware and Michigan provides essentially the same opportunity to minimize corporate formality as the Supplement. However, the state laws should be clarified to state unambiguously that annual meetings are not necessary. Additionally, Michigan should not require bylaws.[295] Furthermore, Delaware law is distinctive in that shareholder agreements require only a majority vote rather than unanimous consent. Because such agreements can radically change the usual corporate structure, the unanimous consent requirement of the Supplement and the Act is the preferred approach.[296]

C. Protection from Oppression

Oppression is a two-edged sword. On one hand, minority shareholders in a close corporation are especially subject to oppression by majority shareholders unless they are protected by a well-drafted, enforceable agreement. On other hand, oppression by minority shareholders is possible when they misuse veto power in such a way so as to create a deadlock.[297] The Supplement attempts to deal with these problems by sanctioning shareholder agreements and providing a wide range of remedies to resolve shareholder disputes. As previously discussed, both Michigan and Delaware provide for shareholder agreements, although in Delaware an agreement can be adopted by majority vote over the objection of minority shareholders.[298] Furthermore, Delaware law does not specifically authorize the wide range of shareholder dispute remedies available in the Supplement. In Michigan, however, there has been a reluctance to use all the available remedies.

D. A Separate Close Corporation Chapter

Both Delaware and the Supplement use an integrated approach for close corporation provisions. In each, the provisions are found

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291. Model Stat. Close Corp. Supp. § 21.
292. *Id.* § 20.
293. *Id.* § 22.
294. *Id.* § 23.
295. *See supra* notes 225-227 and accompanying text.
296. *See supra* notes 218-219 and accompanying text.
297. *ABA Report, supra* note 134, at 273.
298. *See supra* note 206 (under § 202, those parties not participating in the restriction agreement are not bound by majority actions).

in a separate chapter of the corporation act and integrated with other chapters of the act.[299] In comparison, the Michigan provisions relating especially to close corporations are spread throughout the corporation statute.

On the surface, the integrated approach with its concentration on close corporations contained in one chapter is appealing because it appears to be easier to use. In fact, however, the opposite is true for the reason that provisions in the general corporation act may apply only to close corporations. Consequently, the integrated approach requires constant comparison of general corporation provisions with provisions in the close corporation chapter.[300] The drafters of the Supplement recognized this problem:

> One of the chief criticisms leveled at the existing integrated close corporation statutes is that they are so cumbersome lawyers are afraid to use them. To a large extent, the statutory framework for close corporations will inevitably be somewhat complex because the provisions must be drafted around the existing corporate statutes and case law.[301]

In terms of complexity, the statutory format of the Act is preferable to the other approaches. However, one question remains: Is the complexity of the integrated approach justified by the need for special statutory provisions relating only to close corporations? The preceding analysis indicates that, while selected close corporation provisions are at times beneficial, there is no overwhelming necessity for the integrated approach. Michigan close corporations, in other words, can use general corporation provisions to maximize flexibility, minimize legal formality, and avoid shareholder oppression.

If policymakers disagree with this conclusion and opt for an integrated statute, the Supplement is preferable to Delaware law. While some formality is inevitable with an integrated statute, i.e. , a corporation must elect close corporation status, additional formality—such as a requirement limiting the maximum number of shareholders—is minimized under the Supplement. This should have

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299. Model Stat. Close Corp. Supp., Introductory Comment.

300. *ABA Report, supra* note 134, at 272.

301. The great majority of Delaware corporations that have the option do not elect close corporation status. Thus, in practice, the comparision of general and close corporation provisions is not a major problem. The argument can be advanced, however, that the complexity of the integrated statute is one reason why more Delaware corporations do not take advantage of the close corporation chapter. *See* Blank, *Analyzing Texas Articles of Incorporation: Is the Statutory Close Corporation Format Viable?*, 39 Sw. L.J. 941 (1980) (use of the Texas and Delaware integrated statutes).

the effect of preventing inadvertent termination of close corporation status simply because the owners of a business lack familiarity with the intricacies of close corporation law.[302]

302. *See supra* note 300 and accompanying text.