Analyzing Texas Articles of Incorporation: Is the Statutory Close Corporation Format Viable

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THE original version of the Texas Business Corporation Act (TBCA)\(^1\) did not expressly regulate close corporations.\(^2\) Subsequent amendments in 1973\(^3\) and 1975,\(^4\) however, sought to restate and clarify the Texas law on this business format.\(^5\) To satisfy the current statutory definition of a closely held corporation, for example, a domestic company must elect that status in its articles of incorporation while limiting corporate ownership to no more than thirty-five stockholders.\(^6\) The shares of these individuals must have been privately acquired and constantly subject to restrictions on transferability.\(^7\) Corporations that satisfy these requirements may be referred to as "electing"\(^8\) or "defined"\(^9\) close corporations.

Notwithstanding these amendments, several commentators have chal-

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\(^1\) 1955 Tex. Gen. Laws, ch. 64, § 1, at 239.
\(^7\) Id. arts. 2.30—1(A)(2)-(3). Restrictions on transferability may be imposed under art. 2.22 or the more liberal provisions of art. 2.30—2(A)(2).
\(^8\) Id. art. 2.30—1(A)(4)(E).
\(^9\) See Lebowitz, supra note 5, at 714.
challenged the utility of specific TBCA provisions as well as the overall desirability of using the current defined close corporation format.\textsuperscript{10} These critics charge that the present statute is an excessively complex, ill-structured mixture of procedural and substantive elements that necessitates the drafting of many complicated documents.\textsuperscript{11} Inadequate statutory guidelines for the exercise of management options, such as the appointment of provision directors or dissolution of the company at will, may lead to such imprudent use of these techniques that a close corporation may not qualify for taxation as a corporation.\textsuperscript{12} More frequently, however, commentators focus on the managerial flexibility statutorily available to both electing and nonelecting TBCA corporations, in order to argue that the additional options open only to electing corporations are of little significance to corporate planners.\textsuperscript{13} In light of the fact that increased managerial latitude is a major theoretical advantage of the defined close corporation, the statutory grant of similar license to nonelecting companies may diminish the relative value and magnify the perceived disadvantages of the defined close corporation format.\textsuperscript{14}

To date, no study has compared and analyzed the actual exercise of the options available in drafting the articles of incorporation for electing and nonelecting Texas corporations.\textsuperscript{15} This Article attempts to fill this gap by systematically assessing the frequency with which such options, including the election of close corporation status, are actually used in a large sample of recent Texas incorporations. In view of the controversy concerning managerial freedom under the Texas Business Corporation Act, however, a review of the statutory control options applicable to electing and nonelecting Texas corporations precedes a discussion of the results of this study.

\textsuperscript{10} See, e.g., F. ELLIOTT & R. HAMILTON, supra note 5, §§ 2.1-2; R. HAMILTON, supra note 5, § 697, at 39; Bateman & Dawson, supra note 2, at 975; Bromberg, Corporate Organizational Documents and Securities—Forms and Comments Revised, 30 SW. L.J. 961, 970 n.20.5(B) (1976); Hamilton, Corporations, Annual Survey of Texas Law, 30 SW. L.J. 153, 187-88 (1976).

\textsuperscript{11} See R. HAMILTON, supra note 5, § 697, at 39; Bromberg, supra note 10, at 970 n.20.5(B); Hamilton, supra note 10, at 187-88.

\textsuperscript{12} F. ELLIOTT & R. HAMILTON, supra note 5, §§ 2.1-2.

\textsuperscript{13} See, e.g., id., § 2.2, at 83; Karjala, Special Close Corporation Legislation: An Idea Whose Time Has Come and Gone, scheduled for publication in vol. 58, no. 7 of Texas Law Review.

\textsuperscript{14} See TBCA art. 2.30—1, Comment, at 205 (Vernon 1980); F. ELLIOTT & R. HAMILTON, supra note 5, § 2.2, at 83. See also note 11 supra and accompanying text.

I. STATUTORY FLEXIBILITY IN THE MANAGEMENT OF ELECTING AND NONELECTING TBCA CORPORATIONS

The current Texas statute permits considerable flexibility in the management of the internal affairs of a defined close corporation. For example, shareholders can elect to manage the company without a board of directors. Shareholder agreements may stipulate how certain corporate operations are to be handled, while the articles of incorporation define the qualifications of all future stockholders. When faced with a corporate deadlock, these shareholders may seek the appointment of a provisional director or use liberal dissolution provisions. Finally, shareholders may commence judicial proceedings to prevent the loss of defined close corporation status. The availability of these options has led at least one commentator to call the Texas close corporation format a "valuable new approach to incorporating."20

While some commentators acknowledge that electing corporations may derive certain advantages through the use of these provisions, the majority point to specific provisions of the TBCA that they claim provide the same type of managerial freedoms to nonelecting corporations. These critics first question whether the shareholder management provision of the electing close corporation statute is of practical value. This argument emphasizes that the positions of incorporator, registered agent, and director, required under the general corporation statute, may be performed by a single individual. Since this individual may also be a shareholder in the nonelecting company, critics contend that most Texas corporations may enjoy parallel freedom in shareholder management without making the formal election. In addition, the shareholders in a nonelecting corporation may be given control over a broad spectrum of other general corporate functions, such as the contents of adopted corporate bylaws or the power to call shareholder meetings. Shareholders may also establish voting approval margins that differ from the statutory percentages necessary to ratify certain corporate activities. The delegation of such authority theoretically should strengthen the nonelecting shareholders' control in

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16. TBCA art. 2.30—1(G) (Vernon 1980).
18. See TBCA arts. 2.30—4, —5 (Vernon 1980).
19. Id. art. 2.30—3.
20. Comment, supra note 17, at 355.
21. See, e.g., F. Elliot & R. Hamilton, supra note 5, § 2.2, at 83.
22. See generally TBCA art. 2.30—2 (Vernon 1980).
23. See id. arts. 2.09(A)(2), _32(A), 3.01(A).
24. E.g., R. Hamilton, supra note 5, § 2.5, at 86.
26. Ordinarily, a two-thirds vote of the outstanding shares is necessary to amend the charter, to merge, or to dissolve the corporation. See TBCA arts. 4.02(A)(3), 5.03(B), 6.03(A)(3) (Vernon 1980). These voting margins can, however, be reduced to a simple ma-
managing the company.\textsuperscript{27} In fact, the results of this study lend some support to the contention that management and ownership may overlap significantly within nonelecting companies.\textsuperscript{28} In the nonelecting corporate context, however, this overlap neither relieves Texas corporations of their obligation to satisfy various corporate formalities nor protects their participants from the liability that results from a failure to comply.\textsuperscript{29} Thus, insofar as the shareholder management provision for electing corporations appears to diminish these risks, the provision may be said to afford additional protection that is not available to nonelecting corporations.\textsuperscript{30}

Other commentators on the close corporation statute question the value of the shareholder agreement provision.\textsuperscript{31} The argument notes that the TBCA also permits nonelecting corporations to use their bylaws as a private means of regulating internal corporate affairs.\textsuperscript{32} In addition, a broad variety of other provisions permits the regulation of specific corporate activities. Large boards, for example, can conduct their business without formal meetings through telephone conferences or at regularly scheduled meetings with increased quorum requirements.\textsuperscript{33} The TBCA also currently countenances the use, by all Texas corporations, of voting trusts, several stock series with different voting rights, limitations on preemptive, cumulative, and stock transfer rights, as well as the issuance of multiple or fractional shares.\textsuperscript{34} If management is concerned about the security of the directors' positions on the board, that group may be classified or limited in size to the number of initial directors who can only be removed for cause.\textsuperscript{35} Similar concerns may call for the inclusion of provisions that indemnify corporate officials or the use of interested party provisions that permit the corporation to deal with those persons in their individual capacities.\textsuperscript{36} Alternatively, several of the board's powers, such as declaring dividends or calling for the repurchase of stock, can either be delegated to a committee or limited by the articles of incorporation.\textsuperscript{37}

These latter provisions permit a great deal of control over the operation

\begin{footnotes}
\footnotetext{27}{See, e.g., O'Neal, \textit{Close Corporation Control Devices}, 61 ILL. B.J. 118, 122 (1972).}
\footnotetext{28}{See generally notes 64-74 infra and accompanying text; see also Lebowitz, \textit{supra} note 5, at 716-17.}
\footnotetext{29}{For an analysis of the problem of piercing the corporate veil, see generally Hamilton, \textit{The Corporate Entity}, 49 TEXAS L. REV. 979 (1971).}
\footnotetext{30}{In fact, shareholder management is widely recognized as one of the most attractive advantages of the defined close corporation format. See, e.g., F. ELLIOT & R. HAMILTON, \textit{supra} note 5, \S 2.2, at 83.}
\footnotetext{31}{See, e.g., Bromberg, \textit{supra} note 10, at 971 n.21.}
\footnotetext{32}{See generally TBCA art. 2.23 (Vernon 1980).}
\footnotetext{33}{See id. arts. 2.35(A), 9.10(B), (C).}
\footnotetext{34}{Id. arts. 2.12(A), .13(A)(7), .22, .22—1, .29(A)(1)(a), .29(D), .30.}
\footnotetext{35}{Id. arts. 2.32(A), .33(A).}
\footnotetext{36}{Id. art. 2.02(A)(16); Bromberg, \textit{supra} note 10, at 973-77. See generally Knepper, \textit{Corporate Indemnification and Liability Insurance for Corporation Officers and Directors}, 25 SW. L.J. 240 (1971); Comment, \textit{Mandatory Indemnification of Corporate Officers and Directors}, 29 SW. L.J. 727 (1975); Comment, \textit{The Interested Director in Texas}, 21 SW. L.J. 794 (1967).}
\footnotetext{37}{See TBCA arts. 2.03(C)-(D), .36(A) (Vernon 1980).}
\end{footnotes}
of TBCA corporations; however, the same provisions are applicable to
defined close corporations as well. Their availability to both business for-
mats, therefore, narrows the inquiry on this point to the relative flexibility
of these two methods in obtaining informal agreement among the share-
holders. When so focused, the language of the close corporation statute
provides the dispositive benefit. Furthermore, since this statute provides
for the enforcement of shareholder agreements among the participants in a
defined close corporation when the same agreement would not be enforce-
able in a nonelecting corporation, it appears to have the advantage of en-
forceability as well as flexibility.

In evaluating the ability of defined close corporations to stipulate the
qualifications of future shareholders, critics of the statute point to the
TBCA provision permitting the imposition of share transfer restrictions on
all corporations. These provisions may theoretically have the same effect
by limiting the number and types of individuals to whom shares can later
be transferred. An assessment of this argument must include the recogni-
tion that the special abilities of one member of a close corporation are
often extremely important to the other members. The ability of share-
holders in a close corporation to control this variable directly seems more
desirable than indirect attempts using share transfer restrictions.

In considering the statutory close corporation’s advantage of regulating
deadlock and dissolution, one can point to the availability of the general
dissolution provisions of the TBCA. Commentators claim that the share-
holder’s option to call for a provisional director or the dissolution of the
company may be exercised at a time that is problematical for the close
corporation and other stockholders. This argument correctly notes a tacti-
cal consideration for the majority shareholders; however, it fails to recog-
nize that the apparent purpose of the close corporation provisions is not to
ensure the convenience of the majority, but rather to protect the interests
of the minority. This goal appears to be satisfied. Therefore, the liberal
provisions of the close corporation statute regulating dissent and dissolu-
tion appear to set out two more advantages over the general provisions of
the TBCA.

In summary, the current close corporation statute seems to provide the
members of electing closely held companies with somewhat greater opera-
tional latitude in the areas of shareholder management and agreements as

38. Id. art. 2.30—1(A)(4).
39. "If an agreement authorized by this Article contains any provisions which would
not be valid under other provisions of the Act, such provisions shall be valid only so long as
the corporation maintains its status as a close corporation under this Act." Id. art. 2.30—
2(D).
40. See F. ELLIOT & R. HAMILTON, supra note 5, § 2.6, at 87-88.
41. See generally TBCA art. 2.22 (Vernon 1980).
42. Winer, Proposing a New York “Close Corporation Law,” 28 CORNELL L.Q. 313, 314
(1943).
43. See generally TBCA arts. 6.01-.07 (Vernon 1980).
44. See F. ELLIOT & R. HAMILTON, supra note 5, §§ 2.1-2, at 83.
45. Comment, supra note 5, at 728-30.
well as in the regulation of dissent and dissolution.\textsuperscript{46} Before considering whether the actual exercise of these drafting techniques supports this conclusion, however, the methodology employed by this study is outlined.

\section{Methodology}

The sample analyzed in this study consisted of 2,800 articles of incorporation filed with the Texas Secretary of State.\textsuperscript{47} Group 1 contained 1,400 articles processed between June 11, 1979, and June 15, 1979. Another group of 1,400 articles processed between June 12, 1978, and June 16, 1978, was designated Group 2.\textsuperscript{48} Data was collected on the frequency with which various drafting techniques were used in these articles in order to assess the validity of the following theses: (1) Most TBCA corporations possess a majority of the characteristics traditionally associated with the defined close corporation; and (2) a significant number of all Texas corporations elect defined close corporation status in order to make full use of the statutory provisions available solely to that business format.

This study focused on multimember corporations for profit that had never undergone any merger activity. Therefore, any articles amended to merge two corporations or filed to form either a nonprofit corporation or an incorporated sole proprietorship were not analyzed.\textsuperscript{49} Incorporated sole proprietorships were excluded from the sample on the theory that the use of a corporate format by a single individual was not likely to involve many of the drafting techniques pertinent to this study. Nonprofit corporations were excluded because such corporations in Texas are precluded from electing close corporation status.\textsuperscript{50} Finally, articles of merger were excluded on the basis that such articles ordinarily reflect concerns peculiar to major changes in corporate form, rather than considerations normally encountered upon original incorporation.

Applying this procedure excluded few mergers (Group 1: 4/1400 = 0.0029\%), slightly more nonprofit corporations (Group 1: 22/1400 = 1.56\%; Group 2: 82/1400 = 5.86\%), and a relatively large number of incorporated sole proprietorships (Group 1: 279/1400 = 19.93\%; Group 2: 285/1400 = 20.36\%). Thus, the final number of corporations actually analyzed was 1,095 in Group 1, and 1,033 in Group 2. Of the 1,095 corporations ultimately constituting Group 1, 1,037 were nonelecting and 58 were electing corporations. Of the 1,033 Group 2 corporations, 996 were

\textsuperscript{46} See Bateman, \textit{supra} note 5, at 783; Comment, \textit{supra} note 5, at 725.

\textsuperscript{47} See generally TBCA art. 3.03(A) (Vernon 1980) for filing procedures.

\textsuperscript{48} Two separate groups were used to assess differences in the drafting options used in different time periods. As no significant differences were found, data from both groups will be used jointly to support the conclusions reached in the text.

\textsuperscript{49} See generally \textit{Tex. Rev. Civ. Stat. Ann.} arts. 1396—1.01 to —11.01 (Vernon 1980) for the definition of "non-profit corporation" and the filing procedures applicable to such corporations. An incorporated sole proprietorship is a corporation in which the roles of incorporator(s), initial director(s), and registered agent are fulfilled by a single individual or by his attorney. See generally Fuller, \textit{The Incorporated Individual: A Study of the One-Man Company}, 51 \textit{Harv. L. Rev.} 1371 (1938).

\textsuperscript{50} TBCA art. 2.01(A) (Vernon 1980).
nonelecting and 37 elected close corporation status. The nonelecting corporations formed the relevant test groups for Thesis Number One, while the electing corporation groups were the focus of Thesis Number Two.

A methodological limitation of this study stems from the fact that only articles of incorporation on file with the secretary of state’s office were available for analysis. \(^5\) Under Texas law, several drafting options that may be included in these articles may also be included in either the corporate bylaws or in shareholder agreements. \(^5\) These collateral instruments are matters of public record only if filed with the articles, and many shareholders evidently prefer to preserve the privacy of these instruments. \(^5\) Several factors nevertheless support the validity of this study’s format. First, other studies involving nonelecting corporations have used similar methodology. \(^4\) In addition, the approach selected strives to make the best use of the available data. Finally, and most significantly, several important drafting options analyzed in this study must be included in the articles of incorporation themselves to have the desired effect. \(^5\) Thus, the results of the present focus upon incorporators’ actual exercise of drafting options in their articles may be useful to those concerned with the viability of the close corporation statute, despite the inaccessibility of agreements and by-laws.

III. Thesis Number One: Most TBCA Corporations Possess a Majority of the Characteristics Traditionally Associated with the Defined Close Corporation

A. The Traditional Definition

Formulating a universally acceptable definition of the close corporation has been a difficult task for both courts and commentators. \(^5\) While commentators’ interpretations of the statutory definitions vary, most agree that

\(^5\) See note 47 supra and accompanying text.

\(^5\) See, e.g., TBCA arts. 2.02(A)(16) (interested party provisions), 2.03(C)-(D) (limits on repurchase of stock), 2.22(B) (share transfer restrictions), 2.24(A) (location of shareholders meetings), 2.24(C) (calling of special shareholder meetings), 2.30(A) (voting trusts), 2.30—2(B) (shareholder agreements), 2.32(A) (number, election, and removal of directors), 2.33(A) (classification of the board), 2.35(A) (quorum requirements for board meetings), 2.36(A) (delegation of various powers to the board), 9.10(B) (board consent to operate without formal meetings), 9.10(C) (use of telephone conferences as meetings) (Vernon 1980).

\(^5\) See Incorporation Planning, supra note 15, at A-3; Bromberg, supra note 10, at 981 n.61(E).

\(^5\) See generally note 15 supra.

\(^5\) See, e.g., TBCA arts. 2.12(A) (authorization and classification of shares), 2.13(A)(7), (stock series with differing voting rights), 2.22—1(A) (limitation of preemptive rights), 2.23(A) (control over adopted bylaws), 2.28(A) (quorum at shareholders’ meeting), 2.29(A)(1)(a) (multiple or fractional shares), 2.29(D)(1) (voting of shares and cumulation), 2.30—1(B) (qualifications of shareholders), 2.30—1(G) (shareholder management), 2.30—5(A) (dissolution at will), 2.32(A) (number, election, and removal of directors), 3.02(A)(5) (designation of classes of stock), 3.02(A)(6) (designation of preferred stock), 3.02(A)(8) (denial of preemptive rights), 3.02(A)(11) (registered office and agent), 3.02(A)(13) (incorporators), 9.08(A) (changes in required shareholder voting margins) (Vernon 1980).

neither the economic worth nor volume of business of a corporation is dispositive.\textsuperscript{57} Although one could argue that any nonpublicly held corporation is closely held,\textsuperscript{58} this extremely broad definition does not add contour to the present inquiry because none of the analyzed corporations was publicly traded.

A more useful definition might result from combining four characteristics traditionally associated with the close corporation: (1) the size/function requirement that a small group of individuals attempts to fulfill several, if not all, of the legally required corporate roles;\textsuperscript{59} (2) the transferability requirement that restricts the transferability of corporate shares to outsiders;\textsuperscript{60} (3) the control element, by which a broad variety of devices may be used to manipulate corporate operations; and (4) the protection element, by which these devices protect officers and directors from the loss of financial or occupational security.\textsuperscript{61}

While all of these features may characterize a particular corporation, at least one commentator has correctly noted that closely held corporations need not possess all four.\textsuperscript{62} The commentators seem more concerned that the company be organized and run by a small number of individuals whose rights to transfer shares to corporate outsiders has been limited.\textsuperscript{63} The term "closely held corporation" will, therefore, be used in Thesis Number One to describe those corporations that, at a minimum, satisfy both the size/function and the transferability requirements. The frequent use of control devices or methods to protect corporate lenders will constitute additional support for Thesis Number One, but will not be considered independently dispositive.

B. The Size/Function Requirement

Two main investigations were pursued in order to test this requirement under Thesis Number One. The first analyzed the extent to which the statutorily required roles of incorporator, director, and registered agent were performed by the same individuals (the function aspect). The other considered the frequency with which different numbers of directors and incorporators were used (the size aspect). Data on this latter inquiry clearly indicates that most nonelecting corporations are operated by a group of individuals small enough to satisfy the size aspect of the size/function re-

\textsuperscript{57} See 1 F. O'Neal, Close Corporations § 1.03 (2d ed. 1971).
\textsuperscript{58} Scott, supra note 56, at 741.
\textsuperscript{60} See Kessler, Hooray(!) for the Model Act—The 1969 Revision and the Close Corporation, 38 Fordham L. Rev. 743, 746 (1970); Symposium, supra note 59, at 346; Winer, supra note 42, at 330.
\textsuperscript{62} Winer, supra note 42, at 314.
\textsuperscript{63} See, e.g., F. O'Neal, supra note 57, § 1.02; Israels, supra note 59, at 778-79; Scott, supra note 56, at 744-48; Winer, supra note 42, at 314. This approach is also adopted by the current Texas statute. See TBCA art. 2.30—1 (Vernon 1980).
An overwhelming majority of these corporations used no more than three incorporators (Group 1: 998/1037 = 96.24%; Group 2: 899/996 = 90.26%). A very high percentage of nonelecting corporations also used no more than three directors (Group 1: 921/1037 = 88.81%; Group 2: 896/996 = 89.96%).

The function aspect of this initial requirement appears to be satisfied as well. As suggested earlier, the greater the concentration of important roles in the hands of a few, the more perfectly the corporation satisfies this facet of the traditional close corporation concept. Data on the activities of both incorporators and directors reveals this type of concentration within the nonelecting corporations surveyed. For example, at least one incorporator also served as the registered agent in a majority of the nonelecting corporations studied (Group 1: 579/1037 = 55.83%; Group 2: 610/996 = 61.24%). This degree of overlap between the roles of registered agent and incorporator, however, may not actually fulfill the size/function requirement. One possible explanation for this result is the fairly common practice of having the attorney who files the articles of incorporation also serve as the registered agent. Because the primary function of the registered agent is to receive service of process on behalf of the corporation, this practice suggests an understandable willingness to leave legal matters to legal counsel.

The degree to which incorporators also serve as initial directors is the more probative inquiry with respect to the fulfillment of the size/function criterion. According to traditional notions of corporate governance, incorporators bring the corporation into existence, but other individuals manage it. The data reveals a polarity of results, however, that does not directly support this hypothesis. A majority of the nonelecting corporations used all of their incorporators on the initial board of directors (Group 1: 601/1037 = 57.96%; Group 2: 598/996 = 60.04%). Yet the percentage of corporations in which none of the incorporators served in this dual role is also quite large (Group 1: 380/1037 = 36.64%; Group 2: 641/996 = 64.65).

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64. Data on the electing close corporations shows the same trend. Few used a corporate incorporator (Group 1: 1/58 = 1.72%; Group 2: 1/37 = 2.70%), while many used three or fewer incorporators (Group 1: 48/58 = 82.76%; Group 2: 31/37 = 83.78%). See also Hayes, Part I, supra note 15, at 440.

65. Since defined close corporations can be operated without a board of directors, see note 16 supra and accompanying text, several corporations used this option (Group 1: 24/58 = 41.38%; Group 2: 11/37 = 29.73%). The vast majority of the remaining defined close corporations used no more than three directors (Group 1: 29/34 = 85.29%; Group 2: 24/26 = 92.30%).

66. See note 59 supra and accompanying text.

67. The data on the defined close corporations reveals this same trend, but with more impressive results (Group 1: 46/58 = 79.31%; Group 2: 30/37 = 81.08%).

68. The folder in which the secretary of state files approved articles of incorporation includes the correspondence that accompanied the articles upon submission. The vast majority of those cover letters appeared to be from attorneys.

69. See TBCA art. 2.09, Comment (Vernon 1980).

70. Defined close corporations exhibited a more pronounced tendency to have all incorporators double as initial directors (Group 1: 29/34 = 85.29%; Group 2: 24/26 = 92.31%).
The size of this latter category may appear to cast some doubt upon the validity of Thesis Number One. This result, however, can best be understood by examining the usual role of the filing attorney. Although no independent data was collected on this point, an informal assessment suggests that many of these companies were incorporated by members of the filing attorney's law firm. Furthermore, the relatively minor role performed by the incorporator in preparing and filing the articles of incorporation does not involve ongoing corporate management.

Besides those corporations with no incorporators on the initial board because of attorneys' initial involvement in incorporation, most other nonelecting corporations used all their incorporators as initial directors (Group 1: 91.3%; Group 2: 95.6%). This result supports the contention that most TBCA companies satisfy the function aspect of the first requirement in the traditional definition. While the evidence is not uncontroversial, the results discussed in this section consistently depict the typical nonelecting corporation as organized and managed by a small nucleus of individuals who either perform the required corporate functions themselves or assign a few isolated tasks to individuals they believe to be better qualified. This profile seems satisfactorily to capture the essence of the size/function requirement.

C. The Transferability Requirement

The second requirement of the traditional definition is the imposition of restrictions on the transferability of corporate stock. Texas corporations may satisfy this requirement by imposing reasonable restrictions when those limits are noted conspicuously on the stock certificates. The statute lists five such restrictions that would be enforceable if imposed. The data, however, indicates that none of these statutorily sanctioned options

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71. Only a small percentage of the incorporators of the defined close corporations failed to serve this dual role (Group 1: 5/34 = 14.71%; Group 2: 2/26 = 7.69%).
72. See notes 68-69 supra and accompanying text.
73. Accord, Bromberg, supra note 10, at 967 n.13(A); Hayes, Part I, supra note 15, at 412.
74. See TBCA art. 3.01(A), Comment (Vernon 1980).
75. See note 60 supra and accompanying text.
76. TBCA art. 2.22(C) (Vernon 1980).
77. Article 2.22(D) of the TBCA provides:
[A] restriction on the transfer or registration of transfer of securities of a corporation shall be valid if it reasonably:
(1) Obligates the holders of the restricted securities to offer to the corporation or to any other holders of securities of the corporation or to any other person or to any combination of the foregoing, a prior opportunity, to be exercised within a reasonable time, to acquire the restricted securities; or
(2) Obligates the corporation to the extent permitted by this Act or any holder of securities of the corporation or any other person, or any combination of the foregoing, to purchase the securities which are the subject of an agreement respecting the purchase and sale of the restricted securities; or
(3) Requires the corporation or the holders of any class of securities of the corporation to consent to any proposed transfer of the restricted securities or
received much actual use. Indeed, only two types of restrictions were used at all. Articles giving the corporation or stated individuals the right of first refusal were used infrequently in both groups (Group 1: 28/1037 = 2.70%; Group 2: 30/996 = 3.01%).

One might conclude from this result that the transferability requirement is not satisfied in nonelecting corporations. Many transferability restrictions, however, may be imposed either by the public articles of incorporation or by private documents such as bylaws and shareholder agreements. Nonetheless, based on the available data, few nonelecting Texas corporations impose transferability restrictions in their articles. One possible explanation for this result is that articles of incorporation tend to be much more difficult to amend than bylaws or other corporate instruments that may contain transferability restrictions. Moreover, a pervasive tendency exists to draft articles of incorporation as simply and broadly as possible. For example, the overwhelming majority of the nonelecting corporations used perpetual duration provisions (Group 1: 1034/1037 = 99.71%; Group 2: 994/996 = 99.80%) and very broad purpose clauses (Group 1: 676/1037 = 65.19%; Group 2: 797/996 = 80.02%). Thus, in light of the opportunity to impose restrictions on transferability by other, more private means, many nonelecting companies may use their articles of incorporation to report the minimum of nonsensitive information required for incorporation.

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78. Accord, INCORPORATION PLANNING, supra note 15, at A-19 n.140. But see Hayes, Part III, supra note 15, at 181. For a discussion of the use of the transferability and other restrictions in defined close corporations, see text accompanying notes 110-12 infra.

79. For a discussion of an interesting use of such restrictions in a defined close corporation, see notes 124-26 infra and accompanying text.

80. See TBCA art. 2.22 (Vernon 1980).

81. The TBCA permits Texas corporations to use perpetual duration clauses. TBCA arts. 2.02(A)(1), 3.02(A)(2) (Vernon 1980). But see Hayes, Part I, supra note 15, at 441. See also INCORPORATION PLANNING, supra note 15, at A-5 n.23. All the defined close corporations used such clauses in their articles. Of those nonelecting corporations that did not seek perpetual duration, three chose 50-year lives and the other two selected 99-year durations.

82. Texas corporations may also use very broad general purpose clauses. TBCA art. 3.02(A)(3) (Vernon 1980). In order to assess the extent to which this statutory license is actually used, the author divided the articles into two groups: those with a general purpose clause and those with a specific purpose clause. Articles in the specific purpose group were sufficiently detailed to permit the reader to predict the company’s main business activities without being simply a form book recital of boilerplate. The remaining corporations were placed in the general purpose category. Roughly the same percentage of defined close corporations as nonelecting corporations were classified as having general purpose clauses. (Group 1: 41/58 = 70.69%; Group 2: 30/37 = 81.08%). But see Hayes, Part I, supra note 15, at 441.

83. See, e.g., INCORPORATION PLANNING, supra note 15, at A-3; Bromberg, supra note 10, at 981 n.61(E).
D. The Control Element

Unlike the transferability requirement, the control element is not strictly required by the traditional definition.\textsuperscript{84} The use of a broad variety of statutorily permitted control devices can nevertheless have a powerful impact on the operation of the close corporation.\textsuperscript{85} The issuance of several series of common and/or preferred stock with different voting rights is one commonly suggested control tactic.\textsuperscript{86} Yet most of the nonelecting corporations surveyed had not chosen that approach in their articles. The vast majority issued only one class of common stock (Group 1: 1007/1037 = 97.10%; Group 2: 972/996 = 97.59%), while only an extremely small number issued either more than one series of common (Group 1: 20/1037 = 1.92%; Group 2: 14/996 = 1.41%) or preferred stock (Group 1: 10/1037 = 0.96%; Group 2: 10/996 = 1.00%).\textsuperscript{87}

The data reveals only one attempt to use the issuance of stock as a means of obtaining or retaining corporate control. All of the nonelecting corporations that issued several series of common or preferred stock also imposed different voting rights on those classes.\textsuperscript{88} Although such an allocation of different voting rights among several classes of stock is an often cited control device,\textsuperscript{89} the use of only one class of securities by such an overwhelming majority of nonelecting corporations is probably another manifestation of the tendency to draft articles of incorporation as simply as possible.\textsuperscript{90}

Texas law permits the use of a broad range of other methods to control more directly the voting mechanism of the TBCA corporation. Yet the data reveals that these techniques are rarely embodied in articles of incorporation. For example, none of the nonelecting corporations in either group granted additional preemptive rights or enlarged the circle of indi-

\textsuperscript{84} See notes 59-63 supra and accompanying text.
\textsuperscript{85} Lebowitz, supra note 5, at 715.
\textsuperscript{86} See O'Neal, supra note 27, at 118.
\textsuperscript{87} None of the defined close corporations issued preferred stock; almost all used only one series of common stock (Group 1: 56/58 = 96.55%; Group 2: 37/37 = 100%). See also Incorporation Planning, supra note 15, at A-14 n.92.

Interestingly, most electing and nonelecting corporations were found to issue predominately par value stock. Approximately 70% of those nonelecting corporations issuing only one series of common stock issued par value stock (Group 1: 738/1018 = 72.49%; Group 2: 694/972 = 71.39%). All the corporations in Group 2 that issued several series of common stock issued par value stock as did 90% of those in Group 1. All of those nonelecting companies that issued preferred stock issued par value preferred. Similarly, the majority of the defined close corporations that issued either a single series (Group 1: 39/56 = 69.64%; Group 2: 26/37 = 70.27%) or several series of common (Group 1: 2/2 = 100%; Group 2: 0/37 = 0%) issued par value securities. See also Incorporation Planning, supra note 15, at A-10 n.60. For a discussion of the capital structure of close corporations, see generally Turley, Changing Capital Structures and Shareholders in a Closely-Held Texas Corporation, 11 Hous. L. Rev. 351 (1974).

\textsuperscript{88} Both of the defined close corporations that issued several series of common stock imposed different voting rights on each class. See also Hayes, Part IV, supra note 15, at 468.
\textsuperscript{89} See, e.g., O'Neal & Janke, supra note 61, at 27-28.
\textsuperscript{90} See note 64 supra and accompanying text.
individuals who can call shareholder meetings. Only one corporation imposed higher shareholder voting ratification margins (Group 1: 1/1037 = 0.09%), whereas sixty-one corporations relaxed these statutory requirements slightly (Group 1: 32/1037 = 3.09%; Group 2: 29/996 = 2.70%). The articles of two other corporations revealed the imposition of both shareholder meeting quorum requirements that differed from the statutory norm and the power to issue multiple or fractional shares (Group 2: 2/996 = 0.20%). Other techniques were used somewhat more frequently, although never by a majority of the companies. For instance, a small percentage of the nonelecting corporations limited corporate stock repurchases to the amount of unrestricted capital and earned surpluses (Group 1: 46/1037 = 4.44%; Group 2: 54/996 = 5.42%). One Group 2 corporation limited repurchases to the extent of capital surplus (1/996 = 0.10%), while four other charters imposed a single restraint based on earned surplus (Group 1: 3/1037 = 0.29%; Group 2: 1/996 = 0.10%). On the other hand, cumulative voting (Group 1: 257/1037 = 24.70%; Group 2: 191/996 = 19.18%) and preemptive rights (Group 1: 216/1037 = 20.83%; Group 2: 149/996 = 14.96%) were denied in a fairly small proportion of cases.

Although the articles do not indicate a pervasive use of these techniques, the data suggests one tendency. The infrequent use of provisions that increase the list of those empowered to call shareholders' meetings or permit a lower shareholder quorum requirement suggests little willingness to permit the expansion of minority shareholder power, at least through provisions in articles of incorporation. Where utilized, these voting controls apparently are designed to limit the impact of minority shareholders on corporate management. An obvious embodiment of this trend can be seen in the denial of cumulative voting because this ability to combine votes is generally considered an attractive means of achieving minority representation on the board.

Additional evidence of the tendency to confine minority shareholders' power can be found in an analysis of the restrictions on the general activities of corporate officials. If nonelecting corporations, like electing corporations, attempt to concentrate control in the hands of their initial officers

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91. None of the defined close corporations granted these additional rights either. But see Hayes, *Part IV, supra* note 15, at 471-72.

92. The defined close corporations rarely modified the shareholder approval margins statutorily required to ratify dissolutions, mergers, or amendments to the articles of incorporation. Only two in Group 1 (2/58 = 3.45%) relaxed the voting requirement to a simple majority while one in Group 2 (1/37 = 2.70%) imposed voting requirements higher than the two-thirds norm. See note 26 *supra* and accompanying text.

93. In contrast, none of the defined close corporations granted the authority to issue multiple or fractional shares or imposed different quorum requirements. See also Hayes, *Part IV, supra* note 15, at 474-75.

94. None of the defined close corporations used any of these restrictions.

95. All the defined close corporations that denied preemptive rights also denied cumulative voting (Group 1: 5/58 = 8.62%; Group 2: 7/37 = 18.92%). See *Incorporation Planning, supra* note 15, at A-12 n.78.

96. E.g., Symposium, *supra* note 59, at 376.
and directors, one would suspect that those individuals’ corporate power would not be restricted. This pattern is, in fact, what the data reveals.\textsuperscript{97} None of the articles proscribed board actions without formal meetings or through telephone conferences. Only one corporation imposed board quorum requirements different from the statutory norm (Group 2: $1/996 = 0.10\%$) and a few delegated to an executive committee several of the full board’s powers (Group 1: $8/1037 = 0.77\%$; Group 2: $3/996 = 0.30\%$).

\section*{E. The Protection Element}

Because the bulk of the power to control both nonelecting and electing corporations is concentrated in the hands of a few, those controlling individuals might reasonably seek to include in the articles provisions that protect themselves and the corporation from adverse effects that their decisions may have. Specifically, corporate officers and directors presumably would want the articles to include indemnification and interested party provisions. The directors would also seek protection from removal without cause. The data suggests that these presumptions have some basis in fact. Indemnification provisions appeared in a modest percentage of the articles of nonelecting corporations (Group 1: $159/1037 = 15.33\%$; Groups 2: $137/996 = 13.76\%$) and interested party provisions appeared about as frequently (Group 1: $134/1037 = 12.92\%$; Group 2: $137/996 = 13.76\%$).\textsuperscript{98} The use of provisions regulating the removal of directors, on the other hand, was almost negligible, as only three companies in Group 1 permitted removal with or without cause ($3/1037 = 0.29\%$).\textsuperscript{99} On the whole, therefore, few corporations provided significant protection to corporate officials through the provisions of their articles of incorporation.

\section*{F. Conclusion}

The data collected under the size/function element of Thesis Number One clearly supports that initial requirement. Consistent with the traditional close corporation model, the typical Texas nonelecting corporation is managed by a rather confined nucleus of individuals.\textsuperscript{100} In other respects, however, the data provides less support for the theory that nonelecting Texas corporations possess most of the traditional close corporation characteristics and management options. Specifically, few nonelecting corporations drafted articles either limiting the transferability of corporate shares,\textsuperscript{101} imposing strict control over internal corporate affairs,\textsuperscript{102} or pro-

\textsuperscript{97} None of the defined close corporations studied imposed any of the permitted restrictions on the general power of the officers and directors.

\textsuperscript{98} Very few of the defined close corporations employed either indemnification (Group 1: $4/58 = 6.89\%$; Group 2: $0/37 = 0\%$) or interested party provisions (Group 1: $0/58 = 0\%$, Group 2: $2/37 = 5.41\%$). See also Incorporation Planning, supra note 15, at A-21 n.150; Hayes, Part V, supra note 15, at 597.

\textsuperscript{99} None of the defined close corporations imposed a provision dealing with the removal of a director. See also Hayes, Part V, supra note 15, at 598-99.

\textsuperscript{100} See notes 64-74 supra and accompanying text.

\textsuperscript{101} See notes 75-83 supra and accompanying text.

\textsuperscript{102} See notes 84-97 supra and accompanying text.
viding protection to corporate officers and directors. Yet the weight of nonempirical authority suggests that such provisions receive frequent use in nonelecting corporations. In light of the probable use of other, more private means of imposing these sensitive provisions, one may reasonably infer that nonelecting Texas corporations enjoy many of the control options traditionally associated with the close corporation format.

IV. Thesis Number Two: A Significant Number of All Texas Corporations Elect Defined Close Corporation Status in Order to Make Full Use of the Statutory Provisions Available Solely to That Business Format

As mentioned earlier, many commentators have counseled against the use of the defined close corporation despite the additional control options available to electing companies. The second principal area of inquiry of this study, therefore, is to determine the frequency with which Texas corporations elect the statutory close corporation format and the extent to which they utilize the additional options. If that choice is made very infrequently, consideration should be given to possible statutory changes that enhance the utility of that business association.

Contrary to Thesis Number Two, only a small percentage of the analyzed corporations elected the defined close corporation status (Group 1: 58/1095 = 5.59%; Group 2: 37/1033 = 3.71%). The inaccessibility of related corporate documents had no impact on this result, as Texas corporations wishing to utilize the close corporation provisions must expressly elect that status in their articles of incorporation. Interestingly, eight of the articles surveyed expressly stated that they did not elect statutory close corporation status (Group 1: 5/1095 = 0.4%; Group 2: 3/1033 = 0.3%). This express denial could reflect an underlying animosity toward the statutory format. Alternatively, the figures may reflect the erroneous belief that all Texas corporations automatically qualify as statutory close corporations unless expressly denied. An earlier version of the statute provided for this result. Given the express provisions of the current statute, however, the initial interpretation seems more feasible.

The data also discloses an unwillingness to use the full statutory freedom available in the operation of the defined close corporation. A fairly large percentage of these companies made use of shareholder management provisions (Group 1: 24/58 = 41.38%; Group 2: 11/37 = 29.73%), but

103. See notes 98-99 supra and accompanying text.
104. For insights into drafting these provisions, see generally Bromberg, supra note 10, at 961-1005; Pelletier & Marsh, Incorporation Planning in Texas, 23 Sw. L.J. 820 (1969).
105. See notes 52-55 supra and accompanying text.
106. See notes 10-13 supra and accompanying text.
108. See TBCA art. 2.30—1(A)(1) (Vernon 1980).
109. See Doty & Parker, supra note 5, at 1018; Lebowitz, supra note 5, at 715.
none imposed qualifications on future shareholders. Very few gave their shareholders the right to dissolve the company at will (Group 1: 5/58 = 8.62%; Group 2: 3/37 = 8.11%). These results strongly suggest that few defined close corporations use any of these three options because each must be included in the articles of incorporation.\textsuperscript{110} In addition, very few electing corporations chose to file shareholder agreements with their articles.\textsuperscript{111} For example, only two Group 1 corporations filed agreements relating to the distribution of profits and future directors or officers (2/58 = 3.45%). Three corporations were to be operated like partnerships (Group 1: 3/58 = 5.17%), while only one charter restricted the transfer of stock so as to retain subchapter S status (Group 1: 1/58 = 1.72%).\textsuperscript{112}

In summary, the data suggests a reluctance to elect the defined close corporation format. The concomitant widespread refusal to include provisions listing qualifications for future stockholders, the election of shareholder management, or the optional dissolution of the corporation in these articles further indicates that those companies that do use the defined close corporations format do not use it as completely as possible.

V. PROPOSED STATUTORY REFORM

The data collected on Thesis Number Two indicates that most Texas corporations do not elect the close corporation format, and that electing companies do not take full advantage of the management flexibility provided by the statute. These results are especially disheartening in view of prior legislative efforts to update the close corporation statute in order to afford special treatment to electing companies.\textsuperscript{113} Given the apparent reluctance to use the close corporation format, the Texas Legislature might pursue one of two approaches in order to further this legislative purpose. First, the legislature could retain the statute's present location in article 2 if substantial effort is made to reduce the perceived complexity of the current provisions.\textsuperscript{114} TBCA article 2.30—1(A) has been particularly criticized for its rather cumbersome structure.\textsuperscript{115} To remedy this problem, the legislature should make that section more comprehensible by incorporating subheadings or dividing it into several separate subsections. This change would have no substantive effect on the election of the defined close corporation status; however, it would be consistent with the underlying desire for simplicity in drafting the articles of incorporation.\textsuperscript{116}

Preferably, the legislature could consider adopting an entirely new version of the close corporation statute. Two drafting programs provide po-

\begin{itemize}
\item \textsuperscript{110} See TBCA arts. 2.30—1(B), (G), —5(A) (Vernon 1980).
\item \textsuperscript{111} See id. art. 2.30—2(B).
\item \textsuperscript{112} I.R.C. \S\S 1371-1379. A related tax planning technique is to elect treatment as "Section 1244 stock." I.R.C. \S 1244. Although none of the defined close corporations chose this status, a small number of nonelecting companies did (Group 1: 18/1037 = 1.74%; Group 2: 14/996 = 1.41%).
\item \textsuperscript{113} See R. HAMILTON, supra note 5, \S 661, at 25; Bateman, supra note 5, at 781-82.
\item \textsuperscript{114} See, e.g., Hamilton, supra note 10, at 188.
\item \textsuperscript{115} See R. HAMILTON, supra note 5, \S 697, at 39; Hamilton, supra note 10, at 188.
\item \textsuperscript{116} See notes 80-82 supra and accompanying text.
\end{itemize}
tential sources for this new statute. First, the American Bar Association (ABA) is currently redrafting the Model Business Corporation Act; in conjunction, the Corporate Law Committee of the Corporation, Business and Banking Law Section of the ABA has drafted a proposed statutory close corporation supplement to the Model Business Corporation Act. The currently proposed draft defines a statutory close corporation as one that includes a provision in its articles stating that it is a statutory close corporation. The draft would permit existing nonelecting corporations to amend their charters in order to make such an election and would allow existing defined close corporations to renounce that status so long as dissenting shareholders have the option to sell out at a fair price. The articles of incorporation could include provisions calling for management without a board of directors or granting certain shareholders the option to dissolve the corporation either at will or upon the happening of a stated contingency or event. As under the current Texas statute, shareholder agreements could regulate a broad variety of internal corporate affairs. Similarly, the draft would permit shareholders to obtain various judicial remedies such as the appointment of a provisional director or corporate dissolution.

The draft also includes several new and potentially useful provisions. First, shareholders who receive offers to sell their shares to corporate outsiders must first offer the shares to the corporation on the same terms. Secondly, the heirs or the estate of a shareholder can offer the shareholder’s shares for sale to the corporation. If the corporation fails to voluntarily purchase these shares, the heirs or estate can obtain a judicially imposed involuntary purchase. The proposed method of enforcement would permit the court to dissolve the corporation if it failed to comply with the purchase order.

Although the ABA’s draft embodies several useful proposals, the Texas Legislature should place special emphasis on the suggestions advanced by a select subcommittee of the Texas State Bar Association’s Committee on the Revision of Corporation Law. This subcommittee, formed in 1979, consists of legal scholars and practitioners who recognize the need for a simpler enabling statute granting greater freedom of contract to the share-

117. Interview with Seth Searcy, Project Director of the Model Business Corporation Act Redrafting Project, University of Texas School of Law (Aug. 20, 1980).
118. Interview with Professor Harry J. Haynsworth, University of South Carolina School of Law (Aug. 22, 1980).
119. ABA COMM. ON CORPORATION LAW, SECTION ON CORPORATION, BUSINESS AND BANKING LAW, PROPOSED STATUTORY CLOSE CORPORATION SUPPLEMENT TO THE MODEL BUSINESS CORPORATION ACT (June 1, 1980).
120. Id. §§ 3(b), 8.
121. Id. §§ 11, 16.
122. Id. § 12.
123. Id. § 17.
124. Id. § 4.
125. Id. § 15.
126. Id.
127. Id.
holders of Texas close corporations. The subcommittee's proposed bill, if enacted, would be codified as a new article of the TBCA and would replace existing provisions elsewhere in the Act. Under the Texas State Bar subcommittee's proposal, a close corporation is defined as one that declares that status in its articles of incorporation. This declaration would be the only procedural difference between forming a close corporation and an ordinary corporation. Thus, as under the current statutory format, consistent provisions of the TBCA would govern the operation of close corporations as well. The proposal also permits previously nonelecting corporations to come under the new statute if the shareholders unanimously agree. Corporations organized under the existing close corporation statute would retain that status provided their stock certificates were changed to note the increased risk and stock transfer restrictions associated with the close corporation format. Currently enforceable shareholder agreements would also remain effective under the new provision.

While this approach admirably reduces the complexity of electing the close corporation format, provisions on the use of shareholder agreements emphasize the drafters' further intent to enhance the freedom of these shareholders to arrange contractually the operations of their companies. The recommendation lists several matters that could be governed by shareholder agreements. While this list is neither exhaustive of all variations of shareholder agreements nor innovative in stating types of arrangements not permitted under the current TBCA, it does attempt to delineate the broad freedom of contract that the shareholders of a close corporation may enjoy. One interesting point must be made on the use of shareholder agreements under this plan. Future shareholders, even those who

128. The members of the committee are Messrs. W. Amon Burton of Austin; Michael M. Boone, George W. Coleman, Marc H. Folladori, Gary Herman, John T. Kipp, Harold F. Kleinman, David G. McLane, George Slover, Jr. of Dallas; and Professors Hal Bateman, Texas Tech Law School; Alan R. Bromberg, Southern Methodist University Law School; and Chairman Leon Lebowitz, University of Texas Law School.

129. SUBCOMMITTEE ON CLOSE CORPORATION PROVISIONS OF THE TEXAS BUSINESS CORPORATION ACT, COMMITTEE ON REVISION OF CORPORATION LAW, SECTION ON CORPORATION, BANKING AND BUSINESS LAW, STATE BAR OF TEXAS, PROPOSED TEXAS CLOSE CORPORATION LAW (July 3, 1980) [hereinafter cited as PROPOSED TEXAS CLOSE CORPORATION LAW]. [Author's note: After this Article went to print, further amendments were made in this proposal.]

130. Id. art. 12.02.
131. Id. art. 12.13(A).
132. Id. art. 12.03(B).
133. Id. art. 12.14.
134. Id. arts. 12.15(A), (C), .51(A).
135. Id. art. 12.15(B).
136. Id. art. 12.32(A).
137. Article 12.32(B) lists: (1) shareholder management, (2) buy-sell agreements, (3) declaration of dividends or division of profits, (4) dissolution at will or upon the happening of a given event, (5) the use of voting trusts, (6) the use of shareholder voting margins that differ from the statutory norms, (7) the use of per capita voting, (8) employment of shareholders, directors, and officers, (9) the disclosure of names of the persons who will serve in those offices, (10) arbitration, (11) qualification of future shareholders, and (12) the process for amending the shareholder agreements.

138. Compare TBCA art. 2.30—2 (Vernon 1980) with PROPOSED TEXAS CLOSE CORPORATION LAW, supra note 129, art. 12.32(B).
purchase an interest in the company without actual knowledge of its shareholder agreements, would be bound by those previously executed documents. These agreements may restrict the right of subsequent shareholders to participate in the management of the corporation but may not limit these individuals' rights to receive dividends or to inspect the list of shareholders. Although this provision may seem to restrict the contractual freedom of subsequent shareholders, it must be read in conjunction with the requirement that a transferor attach copies of applicable shareholder agreements to his stock certificates before a transfer can be effective. Thus all subsequent shareholders would receive constructive notice of the agreements, and the rights of the original parties thereto would be preserved.

The provision regulating the governance of these companies expressly acknowledges the validity of operations with less stringent observance of traditional corporate formalities. One key difference in the state bar committee's proposal, however, is that the election of shareholder management may be made in collateral shareholder agreements rather than in articles of incorporation. While the scheme for attaching all such agreements to the stock certificates before transfer may be sufficient notification of the election of this option, retaining the current requirement of including this election in the articles would be preferable. This latter approach would enhance the probability of actual notice to future shareholders, without inhibiting the operation of the company. This method seems the more desirable, in view of the fact that managing shareholders generally are subject to traditional director liabilities.

The state bar subcommittee's proposal also suggests several methods for handling dissent and dissolution. Shareholders may request judicial relief if a breach of the close corporation agreements is imminent, rather than waiting until after the fact. They may seek the appointment of a provisional director under circumstances substantially similar to those available under the current statute. Alternatively, they may demand the appointment of a receiver-custodian or ask for judicial dissolution of the corpora-

139. Proposed Texas Close Corporation Law, supra note 129, art. 12.34(A).
140. Id.
141. Id. art. 12.51(C).
142. Id. art. 12.35(C).
143. Id. art. 12.31.
144. Compare TBCA art. 2.30—1(G) (Vernon 1980) with Proposed Texas Close Corporation Law, supra note 129, art. 12.32(B)(1).
145. See Proposed Texas Close Corporation Law, supra note 129, art. 12.35(A)(2).
146. Id. art. 12.62(A).
147. Id. art. 12.64 and TBCA art. 2.30—4(A) (Vernon 1980) both provide for the appointment of a provisional director when those empowered to manage the corporation have reached such a state of deadlock that the affairs of the corporation can no longer be conducted to the advantage of the shareholders generally.
As judicial remedies are not exclusive, the proposal lists several ways in which close corporation status can be terminated. Termination may occur upon the occurrence of events listed in either the articles or bylaws, upon the amendment of the articles, or upon the merger or consolidation of the company.

VI. Conclusion

Many practitioners and observers view the statutory close corporation as a potentially useful device for obtaining the limited liability of a corporation without sacrificing the flexibility in management and freedom of contract traditionally associated with partnerships. The present study depicts the typical Texas corporation as a small group of active corporate participants in whom the responsibilities of ownership and management merge. The data reveals less support for the traditional notion that most closely held corporations impose stock transfer restrictions, use a broad range of control devices, and provide significant protection for corporate management. This result is perhaps best explained by the availability of other, more private means for imposing those provisions. The most surprising result, however, is that so few corporations elect and fully use the defined close corporation format.

In view of recent legislative attempts to improve the close corporation statute, Texas lawmakers are likely to be surprised and disappointed by this very infrequent use of the statutory close corporation format. This Article therefore has explored the viability of two proposed statutory revisions. The American Bar Association proposal is particularly useful in granting the corporation a right of first refusal and the heirs of current shareholders a call option on their shares. The proposal of the subcommittee of the Texas Bar Association, on the other hand, provides a simplified procedure for acquiring statutory close corporation status and broader judicial remedies. Whatever the source for reform, the results of this study indicate the need for further legislative action to encourage greater use of the statutory format. With the options available to it, the Texas Legislature is in a position to make an informed decision on the next stage in the evolution of the close corporation.

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148. Proposed Texas Close Corporation Law, supra note 129, arts. 12.64, .65(A)-(B).
149. Id. art. 12.61(D).
150. Id. arts. 12.22-.25.
SOUTHWESTERN LAW JOURNAL

Volume 34  November 1980  Number 4

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