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The New Texas Close Corporation Legislation: A Comparison with Florida and Delaware

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A new set of statutes, carefully tailored for the closely-held corporation, has been enacted by the sixty-third session of the Texas Legislature. The statutes are the work of the Committee on Revision of Corporation Law of the State Bar of Texas and will offer welcome alternatives to the incorporation of a small business. This Comment compares the new Texas articles with Delaware and Florida legislation relating to the close corporation, in an attempt to relate similarities and differences, point out overall effectiveness, and indicate areas for possible improvement. The Delaware statutes were chosen for comparison because they are recognized to be the most complete close corporation statutes yet enacted, while Florida statutes have been chosen for comparison as less than successful examples of close corporation legislation.

The form in which close corporation legislation has been enacted varies from state to state. In Florida, the close corporation statutes form a separate part of the state corporation law and may be considered complete within themselves. In Delaware, the close corporation statutes form a separate subchapter of the Delaware corporation law but are designed to operate together with the general corporation law. The new Texas statutes do not form a separate part or subchapter of the corporation law, but rather, are placed within the existing body of Texas corporate law with the provision that,
"[t]o the extent not inconsistent with [these articles,] . . . all other provisions of the [Texas Business Corporation] Act shall apply to a close corporation as defined herein." Where the close corporation statutes appear to be lacking in specificity, they are evidently designed to be read together with other applicable corporate statutes.

I. THE CLOSE CORPORATION DEFINED

A number of states have already passed close corporation statutes, and it is likely that the trend will continue. In general, a number of characteristics of the close corporation which distinguish it from the publicly held corporation have been recognized and provided for by legislation in various states. Such legislation makes special provision for the close corporation by defining the close corporation, restricting the number of shareholders, prohibiting the public offering of stock, and enforcing transfer restrictions on stock, with statutory provision to formulate and terminate the close corporation. If the shareholders later desire, the close corporation may assume the status of a publicly held corporation. Or, the close corporation status may be enforced if the corporation has violated the definitional requirements. Special privileges are often provided to minority shareholders, including the right to dissolve the corporation in the event of irreconcilable shareholder conflict. If necessary, a receiver may be appointed to avoid dissolution. A wide range of shareholder control agreements are possible, so long as they are listed in the articles of incorporation or the bylaws, including provisions to allow the shareholders to act as directors of the corporation or to run the corporation as if it were a partnership. Voting agreements among shareholders are also permissible, and such agreements may alter the usual requirement for majority approval of matters voted upon.

The various close corporation statutes already enacted give recognition to a relatively new concept in corporation law which has been defined in a number of ways. Unfortunately, it may be that the difficulty of finding a

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9 Arkansas, Delaware, Florida, Iowa, Maryland, Massachusetts, New York, North Carolina, Pennsylvania, Rhode Island, South Carolina, and Tennessee have adopted some form of close corporation legislation, either as isolated statutes within existing corporation law, or as complete subchapters or parts of the state corporation law.
14 The problems of defining the close corporation have been discussed in a number of articles. For this reason, only a limited discussion of the definitional aspects of the close corporation is here attempted. For detailed discussion of problems in defining the close cor-
satisfactory definition for the close corporation has discouraged state legislation from attempting to formulate and adopt special close corporation provisions. Broadly, the close corporation has been defined as a "corporation whose shares are not generally traded in the securities market," and has been said to have "an almost complete identity between management and ownership." A more inclusive definition attempts to emphasize the active, day-to-day management of the business by its voting shareholders as a unique characteristic of the close corporation.

Close corporation legislation basically attempts to provide flexibility in the control and functioning of the corporation. Unnecessary corporate formalities are eliminated; shareholders are given wide discretion in choice of methods by which they control the corporation; and finally, shareholder conflict and deadlock situations are dealt with in an effort to avoid dissolution. As a result of legislation, a number of states now permit operation of the corporation without a board of directors, and encourage utilization of such arrangements as stock transfer restrictions, greater-than-majority vote requirements, and other shareholder agreements that would be prohibited in the control and management of a publicly held corporation.

General definitions of the close corporation notwithstanding, each state has selected certain definitional aspects for its close corporation legislation. The variations in the definitional approach taken by each state are the first bases of comparison. The new Texas legislation defines a close corporation as one in which there are no more than fifteen shareholders, whose issued shares shall be subject to one or more restrictions on transfer and whose

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5 See O'Neal, Developments in the Regulation of the Close Corporation, 50 CORNELL L.Q. 641, 644 (1965).
6 See also O'Neal § 1.2.
7 Tennery, supra note 14, at 243. See also discussion, id. at 246-50.
8 A close corporation is one "in which the owners of all the voting securities are engaged in the management of the corporation. (1) Voting securities do not include those securities to which voting rights accrue only on the happening of a contingency. (2) Management means (a) active participation, apart from the exercise of voting rights, in the formulation of corporate policy or in the making of decisions which affect corporate policy or (b) day-to-day duties involving supervision of corporate operations or personnel." Note, Definition of the Close Corporation, 16 VAND. L. REV. 1267, 1272 (1963).
9 For a state-by-state breakdown of these and other features of the close corporation statutes, see Comment, Delaware's Close Corporation Statute, 63 NW. L. REV. 231 nn.8-10 (1968). See also O'Neal § 1.14; Hetherington, Special Characteristics, Problems and Needs of the Close Corporation, 1969 ILL. L.F. 1, 5-11.
shares have been issued without any public offering. Delaware permits thirty shareholders, requires issued shares to be subject to one or more restrictions on transfer, and prohibits a public offering of the shares. Florida does not limit the number of shareholders, but utilizes a more generic definition: “a close corporation means a corporation for profit whose shares of stock are not generally traded in the markets maintained by securities dealers or brokers.”

The definitional approach of the three states should be judged in light of the particular needs of the close corporation to determine how well the statutes meet these needs. Generally, a close corporation suggests a small organization in which the shareholders are acquainted with one another and are active in the control and management of the business. Although restricting the number of shareholders to thirty, or even fifteen, may be reasonable, such restrictions are probably unnecessary, since too many shareholders may ultimately lead to violation of other definitional aspects of the close corporation statutes, such as open trading of shares, thereby causing the corporation to lose its close corporation status. Likewise, too many shareholders may make shareholder control cumbersome and difficult. But limitation upon the number of shareholders may, unfortunately, prevent a group of individuals from utilizing close corporation statutes just because they number more than fifteen, or thirty, as the case may be. Nevertheless, limiting the stockholders to fifteen may be considered an integral part of the Texas close corporation legislation, inasmuch as definite provision for the enforcement of close corporation status is included among the proposed statutes. Such provisions indicate the intent that a close corporation should be formed as such and remain so in order to protect original shareholders who purchased shares believing that they would be able to maintain control over the company.

Transfer restrictions on stock, the second definitional aspect of close corporation legislation, have long been recognized as an effective means of keeping a close corporation “close.” Such restrictions, which permit a veto power over potential stockholders and help to preserve original capitalization proportions, have been made an integral part of the Texas and Delaware legislation. Although transfer restrictions are useful in controlling the

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22 TEX. BUS. CORP. ACT ANN. art. 2.30-1 (1973). Restrictions on transfer must be of the type permitted by id. art. 2.22 (1972), which includes any reasonable transfer restriction, such as restrictions defining pre-emptive rights, buy-sell agreements, and first refusal options.


25 See O’NEAL 5.07, at 21.


27 E.g., TEX. BUS. CORP. ACT ANN. art. 2.30-3 (1973).

close corporation, it has been shown that statutory requirements of one trans-
fer restriction, for definitional purposes, will not necessarily insure the close-
ness of the close corporation. Since, in Texas, any sort of transfer restriction
will qualify, it is possible to draft a restriction which qualifies under the
proposed statutes, but does not effectively restrict sale of the close corporation
stock to all outsiders.

Public offering of close corporation stock, the last definitional aspect of
close corporation legislation, is prohibited by Texas, Florida, and Delaware. The
possibility of using any but the private offering exemption of the Securi-
ties Act is, therefore, unnecessary. It has been suggested that the better ap-
proach would be to permit stock registration or an intrastate offering. The
private offering exemption, however, should be entirely adequate for the
close corporation contemplated by the Texas statutes. If shareholders are
limited to no more than fifteen, it is difficult to envision a situation where
utilization of the private offering exemption would not be the simplest and
best approach to the issue of stock.

II. FORMATION OF THE CLOSE CORPORATION

Close corporation legislation should require that a business operating as a
close corporation be clearly identified as such for purposes of notice to credi-
tors, potential shareholders, or other interested parties. Unfortunately, there
are no specific provisions among the new Texas statutes which provide for the
formation of a close corporation, as distinguished from a publicly held corpo-
ration. Nor do the statutes provide for the election of an existing corpora-

18 Comment, Delaware's Close Corporation Statute, 63 Nw. U.L. REV. 230, 235, 243-45
(1968). The transfer restriction requirement could be met simply by adopting a restriction
prohibiting transfers to competitors, or any other such restriction. Since anyone not a com-
petitor could purchase the stock, the transfer restriction would have very little effect in dis-
qualifying potential purchasers.
19 TEx. BUS. CORP. ACT ANN. art. 2.22 (1972).
20 A brief introduction to aspects of the non-public offering requirement, together with
relevant securities legislation, may be found in Comment, supra note 28, at 239. While a
non-public offering requirement may be viewed as unnecessarily restrictive, it has been shown

22 Comment, supra note 25, at 519. Stock registration, intrastate offerings, or other such
considerations are relevant to the Florida statutes because no limit is placed upon the number
of shareholders of the close corporation. In Texas and Delaware, where close corporation
stockholders are limited, the non-public offering requirement is not restricted to the extent
that it is in Florida.
23 See Texas Securities Act, TEx. REV. CIV. STAT. ANN. art. 581-51 (1964). For a de-
tailed discussion of the private placement exemption, see Bromberg, Texas Exemptions for
Small Offerings of Corporate Securities, 18 Sw. L.J. 537 (1964). It should be borne in
mind that, even if the offering is exempt under the Texas Securities Act, there must also be an
exemption under federal securities law or it must be registered under § 5 of the Se-
24 The identification should either be placed in the articles of incorporation, or in a
designation to follow the name of the close corporation. But what should be avoided is an
open-ended approach whereby simply meeting the definitional requirements qualifies a corpo-
ration as a close corporation. Under this approach, certain acts of the corporation could be
void or voidable at a later time if the status of the corporation were uncertain. Any litiga-
tion would first have to establish the proper status of the corporation before proceeding
to determine the validity of the act in question. By contrast, where the articles specifically state
"close corporation," that status should be considered de jure whether or not a de facto close
corporation existed, in accordance with definitional requirements.
tion to become a close corporation. There are, however, provisions which ensure that the corporation must do more than simply meet the three definitional requirements in order to be established as a close corporation. One such provision is the requirement that the articles of incorporation and each stock certificate expressly state that the business and affairs of the corporation will be managed by the shareholders. Problems will arise, however, in the situation where the close corporation shareholders elect to establish a board of directors. Since in this case no notice is required to be stated in the charter or stock certificate, it would not be clear whether the corporation were operating as a close or a publicly held corporation. The presence of certain shareholder agreements in the charter and bylaws would also give evidence that the business was organized as a close corporation, but such evidence might not be conclusive. A simple requirement that the election by the shareholders to organize the business as a close corporation be recorded in the charter would eliminate problems of corporate status which might later arise in a judicial proceeding.

Delaware statutes avoid problems of corporate status by providing that the certificate of incorporation shall state that the corporation in question is a close corporation. Delaware further provides for the election of an existing corporation to become a close corporation by requiring the filing of an amendment to the original certificate of incorporation, such amendment to be approved by a two-thirds vote of holders of record of all outstanding stock. Such provisions are simple, but completely adequate, and eliminate the possibility of questionable corporate status.

Florida makes no special provision for the formation of a close corporation, but provides for the election of an existing corporation to become a close corporation by requiring written consent by the owners of a majority of the voting stock. The Florida legislation has been criticized for its lack of specificity with respect to the formation of a new corporation under close corporation statutes. In Florida the status of a corporation may remain in doubt, since no provision is made for recording or filing notice of that status. Any corporation meeting the definitional requirements may be considered either a close or publicly held corporation.

III. TERMINATION OF THE CLOSE CORPORATION: SHAREHOLDER CONFLICT PRIVILEGES

In general, a close corporation may be terminated through loss of close corporation status, voluntary dissolution by shareholders, or involuntary dissolution resulting from shareholder deadlock and disagreement. Loss of close corporation status can occur involuntarily, by operation of law when defi-
tional requirements are no longer met, or voluntarily, by vote of stockholders who seek general or public corporation status. Loss of close corporation status does not mean that the business ceases to continue, as is the case with dissolution. Rather, the former close corporation continues in business as a publicly held corporation.

Loss of Close Corporation Status by Operation of Law. As enacted, a close corporation in Texas may be involuntarily terminated by operation of law when it ceases to meet the definitional requirements by having more than fifteen shareholders. When this occurs, the president of the corporation is required to call a meeting of shareholders to elect a board of directors. If the meeting is not called by the president, any shareholder, whether or not entitled to vote, may call the meeting for the purpose of electing directors. Absent provisions in the charter for the number of directors to be elected upon termination of close corporation status, three directors will be elected and close corporation status ceases.

Delaware provides for the loss of close corporation status by operation of law when any one of the three definitional requirements are no longer met. Florida statutes embody no special provision for dissolution by law when definitional requirements cease to be met. Lack of such provisions may result from the broad definition of the close corporation in Florida. Presumably, termination of close corporation status could result only when shares are openly traded.

Although close corporation status may cease upon failure to maintain definitional requirements, both Texas and Delaware have provisions which permit shareholders, if they choose, to enforce the close corporation status. Florida statutes lack such provisions. In Texas, any stockholder may file a petition in any court of competent jurisdiction to prevent the corporation from losing its status as a close corporation by enjoining the performance of any act which will cause loss of that status. Likewise, the power of the court may be invoked to prevent transfer of shares in violation of restrictions on transfer or public offering or solicitation of shares. By means of these provisions, the shareholders' investment is protected; what was initiated as a close corporation remains a close corporation so long as shareholders choose to exercise the privilege of seeking restraint of any act that would lead to a loss of close corporation status.

The Delaware provisions for proceedings to prevent loss of close corporation status are similar to the proposed Texas statutes. The corporation, or

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41 Tex. Bus. Corp. Act Ann. art. 2.30-1C (1973). Although there are three definitional requirements, this article mentions only the first and second requirements (stockholders limited to 15, holding shares in accordance with restrictions on transfer). This article would probably apply to the violation of restrictions on public offering of shares.

42 Id.


44 I.e., stockholders in excess of 30, transfer of stock in violation of restrictions, or a public offering of stock, id. § 342.


47 Id. art. 2.30-3C.
any shareholder, may sue to prevent loss of status. In addition, the Delaware statutes require the corporation to notify the secretary of state within thirty days upon the discovery of a breach of a qualifying condition. If necessary steps are not taken to correct the situation, an automatic termination of close corporation status results.

Loss of Close Corporation Status by Vote of Shareholders. Only Delaware makes specific provision for voluntary termination of close corporation status. If the shareholders decide to transform their close corporation into a publicly held corporation, they may, with the approval of the holders of two-thirds of the shares outstanding, amend the charter to obtain general corporation status. If provided by the certificate of incorporation, more than a two-thirds vote may be required, and any amendment to such a provision will require the same vote as required to terminate the close corporation status. Such requirements make it easier for the incorporators to protect the close corporation status if they have so provided in the articles of incorporation.

In Florida and Texas no specific provisions exist as to voluntary termination of close corporation status. In Texas the problem is further complicated because, as already indicated, no provision is made for the formation of a close corporation, causing requisites for termination to be equally unclear. Since there are no specific provisions, other applicable statutes outside the close corporation provisions, but within the Texas Business Corporation Act, must be utilized. Presumably, only amendment of the articles of incorporation, in accordance with general corporation statutes, would bring about the change in status. Amendment of the articles would require approval of holders of two-thirds of the stock outstanding. When there is no board of directors in the close corporation to approve submission of the amendment to the shareholders, as required, the shareholders themselves would be deemed to be directors. If, for any reason, the articles of incorporation could not be amended to effect the transformation to a publicly held corporation, complete dissolution would be the only remaining possibility to terminate close corporation status.

Termination of Close Corporation Status by Involuntary Dissolution—Shareholder Conflict Privileges. In addition to termination of close corporation status by operation of law or by vote of shareholders, close corporation status may be terminated by forced or involuntary dissolution when severe disagreement and deadlock among shareholders preclude any reasonable possibility of continuing the business. In such a situation, important shareholder conflict

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49 Id. § 348(a) (1).
50 Id. §§ 348(a) (1), (2).
51 Id. § 346.
52 See notes 34–40 supra, and accompanying text.
54 Id. art. 4.02A (1). This article requires the board of directors to approve any amendments to the articles of incorporation. Since in the close corporation, a board of directors is not required, the shareholders will be deemed to be the directors as indicated by article 2.30-1B (1973).
privileges are involved: privileges which can be exercised in time of deadlock or disagreement which help to protect individual shareholder interests. Such privileges might include the right to compel dissolution of the corporation, arbitration in time of deadlock, appointment of a receiver to liquidate the corporation, or simply the right to demand repurchase of individual shares by the corporation at a fair valuation. In the situation of disagreement or deadlock, the protection of minority shareholders is particularly critical.

It has been suggested that a minority shareholder should be protected if he wants to dispose of his interest, even if he has not bargained for the privilege of withdrawing from the business. He should be able to liquidate his investment on fair terms. Assuring the right of any shareholder to compel dissolution is another means to achieve minority protection, but only Florida grants this right. Florida statutes give to the circuit court the power to dissolve close corporations involuntarily upon the petition of any shareholder when the directors are deadlocked in management or the shareholders are deadlocked in voting power and arbitration or other remedies have failed. This is unquestionably the most liberal of the three states' provisions.

Although Texas permits any shareholder to petition the county court to enforce, "by injunction, specific performance, or other such relief," an agreement among shareholders, and to order dissolution if the shareholder makes a motion to have the corporation dissolved, such provision does not protect the minority shareholder who has failed to make any protective agreement which the court could enforce. Texas should simply provide, as does Florida, that any shareholder may petition for dissolution.

Termination of Close Corporation Status by Voluntary Dissolution. Although Florida makes no provision for voluntary dissolution of the corporation by shareholder agreements, both the Texas statutes and Delaware statutes provide for the voluntary dissolution of a close corporation by the shareholders when the articles of incorporation grant a certain percentage of shareholders the option of having the corporation dissolved, at will or upon the occurrence of any event or contingency. Delaware statutes further provide that if the articles of incorporation do not contain such dissolution provisions, the articles may be amended by unanimous vote to include a provision for shareholders' option to dissolve. A unanimous vote is required for amendment unless the articles of incorporation specifically provide otherwise; but in no case may less than a two-thirds vote of all shareholders be required. Both Texas and Delaware statutes require that when a voluntary dissolution provision for a close corporation has been approved, the existence of such a provision must be noted on the face of each stock certificate of that corporation. It may be seen that in
Delaware, Texas shareholders are unprotected when they cannot obtain the required percentage to block or to bring about the dissolution when the articles of incorporation permit voluntary dissolution.

Under Texas close corporation statutes, when the articles of incorporation do not mention shareholder options to dissolve the corporation, other provisions within the Texas Business Corporation Act must be considered. In particular, article 6.02 is applicable, providing that "a corporation may be voluntarily dissolved by the written consent of all its shareholders." The corporation may also be dissolved by a two-thirds vote of all shareholders, whether or not entitled to vote, upon recommendation of the board of directors with notice to all shareholders, such vote to be taken in a shareholder meeting. When there is no board of directors to recommend the dissolution, the shareholders will be deemed directors.

Alternatives to Dissolution: Breaking a Deadlock. Both Texas and Delaware provide alternatives to dissolution. Texas statutes will permit the appointment of a receiver to rehabilitate the close corporation. The receiver may order liquidation and involuntary dissolution only if grounds for such action are met. In addition, the Texas statutes provide for the court appointment of a provisional director when directors or shareholders are deadlocked to the extent that the close corporation can "no longer be conducted to the advantage of the shareholders generally." In contrast to the receiver, the provisional director acts as a director of the corporation until it is able to function once again without deadlock.

Delaware statutes likewise permit the appointment of a custodian or receiver for any corporation when the stockholders are deadlocked and the business of the corporation is threatened with irreparable injury. Alternatively, a provisional director may be appointed when the directors are deadlocked. He has the rights of a duly elected director, including the right to vote, until such time as he is removed from directorship by the court. The provisional director has no authority to take over and manage the corporation in the way that a custodian or receiver would. The Texas and Delaware statutes are, thus, very similar.

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63 E.g., TEX. BUS. CORP. ACT ANN. arts. 6.01-07 (1956).
64 Id. art. 6.02A.
65 Id. art. 6.03A(3).
66 Id. art. 2.30-1B(1) (1973).
67 Id. art. 2.30-3B. The receiver is appointed in lieu of the court's granting injunctive relief upon petition of a shareholder to prevent loss of close corporation status.
68 Grounds for involuntary dissolution are listed in id. art. 7.01 (1971), and include failure to comply with conditions precedent to incorporation, procuring articles of incorporation through fraud, transacting business beyond the scope of the corporate purpose, misrepresentation in reports and affidavits, failure to report or pay fees or taxes, and failure to maintain a registered agent within the state. It is not clear from the wording of article 2.30-3B whether a receiver could be appointed only if loss of close corporation status is an issue. The article should perhaps be expanded to cover any situation involving corporate deadlock. The article might allow enforcement of such measures as arbitration, third-party management, or forced buy-sell agreements before dissolution or rehabilitation could be undertaken by a receiver.
69 TEX. BUS. CORP. ACT ANN. art. 2.30-4A (1973).
70 DEL. CODE ANN. tit. 8, § 352 (Supp. 1968).
71 Id. § 353(a).
IV. AGREEMENTS AMONG SHAREHOLDERS OF A CLOSE CORPORATION: CONTROL PRIVILEGES

One of the advantages of close corporation statutes is the possibility of agreements between stockholders which would otherwise be held invalid in a general corporation when the agreements have the effect of removing control from the directors and vesting it with the shareholders. According to the new Texas legislation, shareholders may regulate basically any phase of business by agreement to which all shareholders of the business have assented. For example, shareholders may manage the corporation, they may place restrictions on transfer of shares, they may operate the corporation as a partnership, and may seek arbitration in time of deadlock. Such agreements must either be written into the articles of incorporation directly or by reference, or be set forth in the bylaws, with the bylaws subject to examination by any shareholder. When such agreements have not been incorporated into the articles or the bylaws, the articles or bylaws may be amended by a unanimous vote of all outstanding shares. Finally, all stock certificates must bear a full or summary statement of shareholder agreements, copies of which will be furnished upon request. Otherwise, the agreements are not binding upon transferees who obtained the shares without notice of the agreements. The requirement that shareholder agreements be in writing, incorporated in the charter or bylaws, has been criticized, since failure to record agreements properly will render them unenforceable at a later date, frustrating the intentions of the shareholders. For this reason, perhaps the new Texas statutes should be reconsidered and such provisions eliminated. The requirement that shareholder agreements be approved by unanimous vote, however, is far-reaching, and ensures better protection of minority interests than is provided in Delaware or Florida.

Florida and Delaware have control provisions comparable to the new Texas statutes. The applicable Florida statutes are similar to the new Texas statutes with respect to the enumeration of phases of business which may be regulated by shareholder agreement. In accord with the more liberal view, Florida does not require that the agreements be incorporated into the charter or bylaws; but contrary to Texas, which would require agreement among all shareholders, Florida permits agreement among "all or less than all" of the shareholders—

72 TEX. BUS. CORP. ACT ANN. art. 2.30-2A (1973).
73 Id. arts. 2.30-2A (1)-(8). Compare FLA. STAT. ANN. §§ 608.75 (1)-(8) (Supp. 1973), with TEX. BUS. CORP. ACT ANN. arts. 2.30-2A (1)-(8) (1973).
74 TEX. BUS. CORP. ACT ANN. arts. 2.30-2B (1), (2) (1973).
75 Id. art. 2.30-2B.
76 Id. art. 2.30-2C.
77 "[P]articipants nevertheless often bargain among themselves for . . . control arrangements but fail to insure that they are implemented by appropriate charter provisions . . . . [T]he result is that important contract rights cannot be enforced, the objectives of the contracting parties are frustrated, and minority participants are deprived of protection for which they bargained." O'NEAL § 1.1c, at 72.
78 For a discussion of the requirement of unanimity among shareholders in the management or control of the close corporation, see Bradley, A Comparative Evaluation of the Delaware and Maryland Close Corporation Statutes, 1968 DUKE L.J. 525, 529-30. The consistent requirement of unanimity is a special feature of the Maryland close corporation statutes.
79 FLA. STAT. ANN. § 608.75 (Supp. 1973).
80 Id. § 608.75 (3).
an unfortunately vague approach. Minority interests consequently suffer. Delaware also permits agreements among shareholders "restricting discretion of directors."\(^8\) Shareholders making such agreements must hold a majority of the outstanding stock entitled to vote.\(^8\) In addition, Delaware does not require the agreements to be incorporated into the charter or bylaws.

Like Florida and Delaware law,\(^8\) in Texas, shareholder agreements may be made with non-stockholders, but such agreements are binding only upon parties to the agreements, thereby protecting the minority shareholders.\(^4\) Texas does not specifically mention the possibility of agreements between shareholders and third parties, nor are such agreements specifically prohibited. The statute simply requires all of the shareholders to assent to the agreement. Texas further provides that if agreements are made which act to relieve the board of directors of certain duties, the shareholders will then be liable for acts or omissions in the area of duty which they undertake to control.\(^4\)

**Voting Agreements.** Close corporation legislation also permits voting agreements among shareholders. Voting agreements are effective in avoiding deadlock which can result when a unanimous vote would otherwise be required. The Texas statutes permit such agreements,\(^8\) but existing statutes restrict their validity to ten years.\(^87\) Delaware\(^8\) and Florida\(^8\) have similar provisions for voting agreements, but Florida imposes no time limitation upon them while Delaware does.\(^8\) A time limitation on voting agreements can be a significant disadvantage if it abridges the minority effectiveness of a voting agreement or causes the agreement to lapse just when it is most needed.\(^9\) On the other hand, a voting agreement not limited in duration might have the effect of locking minority shareholders into a position that has proven unworkable or unfair. Although no specific provisions exist for the enforcement of these shareholder agreements in Delaware and Florida,\(^2\) Texas statutes carefully provide for the enforcement of any restriction or any agreement "among any number of [share]holders."\(^8\)

**Shareholder Management of the Close Corporation.** The new Texas statutes provide for management of the close corporation by the shareholders rather than by the board of directors. The new Texas statutes provide for management of the close corporation by the shareholders rather
than by a board of directors, if the articles of incorporation and each issued
and outstanding share expressly states that such arrangement is binding.\(^9\) Otherwise, shareholders are deemed directors when the context requires,\(^8\) subject to liabilities for acts or omissions.\(^4\) Action with respect to the regulation of the business may be taken by the shareholders "in a manner permitted by the [Texas Business Corporation] Act," with or without a meeting.\(^9\) Shareholder regulation of business is controlled by article 9.10, which permits shareholders to take action to regulate the business if consent in writing is signed by all shareholders entitled to vote. Such consent has the effect of a unanimous vote of shareholders.

Delaware statutes permit stockholder management of the close corporation if this arrangement has been approved by a unanimous vote of holders of all outstanding shares;\(^8\) however, only a majority vote is required to delete the provision for shareholder management from the articles of incorporation. Florida permits shareholder management if provisions are made in the articles of incorporation.\(^9\) With respect to the conduct of business without a meeting, there are provisions similar to the Texas statute, permitting any action of the stockholders to be taken without a meeting if consent in writing, signed by all persons who would be entitled to vote, has been received.\(^10\)

**Partnership Control.** Like Delaware and Florida,\(^10\) Texas\(^10\) permits treatment of the business and affairs of the close corporation as if a partnership,\(^10\) or the arrangement of relations among the shareholders "in a manner that would be appropriate only among partners."\(^10\) Control in a partnership manner is an important aspect of close corporation legislation since it frees the associates in a close corporation from the "obligation to map out their organization along the lines associated with a widely held company."\(^10\) Control of the close corporation may thus be arranged to suit the needs of the corporation and its shareholders as those needs arise, just as in a partnership;\(^10\) and the advantages of limited liability and corporate taxation are not sacrificed. The position of minority interests is protected by operating the business as a partnership, avoiding many corporate "squeeze-out" techniques.\(^10\)

**Removal of Directors.** The Texas statutes provide that the shareholders may

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\(^9\) Id. art. 2.30-1B.
\(^10\) Id. art. 2.30-1B (1).
\(^8\) Id. art. 2.30-1B (2).
\(^4\) Id. art. 2.30-1B (3).
\(^10\) Id. § 608.74.
\(^10\) Bradley, supra note 24, at 1148.
\(^10\) See, e.g., O'Neal § 5.03a.
make agreements to control the terms and conditions of employment of any shareholder, director, or employee, "regardless of the length of time of such employment." Such agreements, so long as they were written into the charter or bylaws, would permit complete shareholder control of the directors. Delaware statutes refer to the possibility of removing a director, while Florida provides for the removal of a director with or without cause "by like action of the stockholders as required for the election of such director," unless there is a contrary shareholder agreement.

V. THE NEW TEXAS LEGISLATION: A BRIEF EVALUATION

From the foregoing comparisons, it may be seen that the new Texas close corporation legislation is basically similar to that of Delaware. There are, however, certain favorable features of the Delaware and Florida statutes, absent from the Texas legislation, which should be considered in appraising the Texas statutes. There are also some features which are not included in any of the three states' legislation which are of importance and ought to be part of the close corporation provisions.

Formation Provisions. The Texas statutes lack specific provisions for the formation of a close corporation or for the election of an existing corporation to become a close corporation. This omission could be remedied by inserting a simple provision, such as Delaware's, requiring the certificate of incorporation to state that the corporation in question is a close corporation.

Voluntary Termination Provisions. There are no provisions among the Texas statutes which would permit voluntary termination of close corporation status by the shareholders, unless so stated in the articles of incorporation. The Delaware statutes, in providing voluntary termination requirements, avoid calling into play other corporation provisions which would require the approval of the board of directors before an amendment to the articles of incorporation could be submitted to the shareholders. Such general corporation provisions are applicable if there are no special close corporation provisions for voluntary termination of close corporation status.

Minority Shareholders' Right to Compel Dissolution. The example that Florida has set by assuring the right of any shareholder to compel dissolution is an example of minority shareholder protection which should be followed by Texas. Additional protection would be provided by guaranteeing the right of an ag-

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109 Del. Code Ann. tit. 8, § 141(b) (Supp. 1972); see discussion in Comment, supra note 25, at 527.
111 See notes 37-40 supra, and accompanying text.
113 See notes 51-54 supra, and accompanying text.
grieved shareholder to compel the corporation to purchase his shares at a fair valuation. But the Texas legislation has, at least, provided that a shareholder’s right to dissolve the corporation may be included in the articles of incorporation. The only drawback to this provision is that it is of no value in time of deadlock if such shareholder dissolution rights have not been included in the articles of incorporation.

Requirement that Shareholder Agreements Be Incorporated into the Charter or Bylaws. The requirement posed by the Texas legislation that all shareholder agreements be incorporated into the charter or bylaws has already been shown to be a requirement that will cause problems if the agreements have not been properly recorded. For maximum flexibility, permitting unhindered control and management of the corporation among the shareholders, the requirement to incorporate all agreements into the articles of incorporation or the bylaws should be reconsidered. In view of the situation where the corporation is run as a partnership, neither Delaware nor Florida require incorporation of shareholder agreement into the charter or bylaws; simply placing the agreements in writing has been considered sufficient.

Time Limitation on Voting Agreements. Texas should remove the ten-year limitation upon voting agreements among shareholders as it relates to the close corporation, since such limitations can work against the minority shareholder.

Minority Shareholder Protection. Crucial in the formulation of any close corporation legislation will be the provisions for the minority shareholder. The concepts of majority rule cannot be applied to the minority shareholder who may be financially unsophisticated and who, as is often the case in a small corporation, may have invested a large portion of his financial resources into a business with the expectation that he will have, and be able to maintain, sufficient control over his investment. It has been pointed out that “no statute—not even any one of the separate, integrated close corporation statutes—furnishes adequate self-executing protection for minority shareholders who have failed to bargain for special charter or bylaw provisions or for protective clauses in shareholders’ agreements.” This is a significant indictment of close corporation legislation in light of the special needs and characteristics of the close corporation and the minority shareholder. If unsophisticated investors are to be permitted the right to incorporate and run a business without a board of directors, with only various mutual agreements to guide them, they should be protected.

Providing for the right of any shareholder to compel dissolution of the corporation is one minority shareholder protection which has not been incorporated into the Texas legislation. But the legislation does provide other significant protection for minority shareholders by requiring a unanimous vote to

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117 Id., art. 2.30-2B; see notes 75-77 supra, and accompanying text.
119 O’Neal § 1.14c, at 74.
approve all shareholder agreements, including amendments to the articles of incorporation or the bylaws. The legislation also specifically provides for the enforcement of shareholder agreements, transfer, and voting restrictions. In addition, any stockholder may petition for the enforcement of any agreement—additional valuable protection for the minority shareholder.

VI. CONCLUSION

The new Texas close corporation statutes go far to achieve a successful series of provisions for the closely-held corporation. No doubt, practical experience with these statutes, as enacted into law by the sixty-third legislature, will suggest further changes to be incorporated from time to time. Even as they now stand, the statutes give evidence of careful consideration and thoughtful formulation; they will provide a valuable new approach to incorporating for business.

APPENDIX

THE NEW TEXAS CLOSE CORPORATION STATUTES

Article 2.30-1, Management of Close Corporation

A. A "close corporation" as used in this Article and in Articles 2.30-2 through 2.30-5 means a domestic corporation (1) which, at any given time, has no more than 15 shareholders of record of all classes of shares, whether or not entitled to vote; (2) whose issued shares of all classes shall be subject to one or more of the restrictions on transfer permitted by Article 2.22 of this Act; and (3) whose shares shall have been issued to its shareholders without any public offering, solicitation, or advertisement. For purposes of determining the number of holders of record of shares of stock in a close corporation as defined in this Article, shares which are held (1) by husband and wife as (a) community property, (b) joint tenants (with or without right of survivorship), or (c) tenants by the entirety, (2) by an estate of a decedent or an incompetent, or (3) by an express trust, partnership, or corporation created or organized and existing other than for the primary purpose of holding shares in a close corporation, shall be treated as held by one person. Nothing in this definition shall be deemed to affect the right of any corporation which is not a close corporation as defined herein or its shareholders or directors to provide for the management of its business and affairs by its shareholders, directors, or officers or to impose restrictions on the transfer of its shares or other securities or to seek any remedy, or to exercise any other power or right, granted or permitted by other provisions of this Act. To the extent not inconsistent with this Article and Articles 2.30-2 and 2.30-3 of this Act, all other provisions of this Act shall apply to a close corporation as defined herein.

B. If the articles of incorporation of a close corporation expressly so state and if each certificate representing its issued and outstanding shares so conspicuously (as defined in Article 2.19 of this Act) states, the business and affairs of such close corporation shall be managed by the shareholders of the close corporation rather than by a board of directors, and the following provisions shall apply:

(1) Whenever the context requires, the shareholders of such close corporation shall be deemed directors of such corporation for purposes of applying any of the provisions of this Act.

(2) The shareholders of such close corporation shall be subject to the liabilities imposed by this Act or bylaw for any action taken or neglected to be taken by directors of a corporation.

(3) Any action required or permitted by this Act to be taken by the board of
directors of a corporation shall or may be taken by action of the shareholders of such close corporation at a meeting of the shareholders or in the manner permitted by this Act without a meeting. In addition, in the event of any action taken by the shareholders, the consent of all the shareholders shall be binding upon the corporation. Such consent may be evidenced (i) by the full knowledge of such action by all the shareholders and their failure to object thereto in a timely manner or (ii) by a writing executed by or on behalf of all the shareholders or (iii) by any other means reasonably evidencing such consent.

C. If a close corporation ceases to meet the definition of a close corporation as set forth herein by reason of having more than fifteen (15) shareholders entitled to hold shares in the corporation in accordance with any restriction on the transfer of shares permitted by Article 2.22 of this Act or any provision of an agreement among shareholders of a close corporation permitted by Article 2.30-2, whether or not all such shareholders are entitled to vote, the president shall call a special meeting of the shareholders entitled to vote thereon to elect a board of directors; and if he fails to call such a special meeting within four (4) months from the date when the corporation ceases to qualify as a "close corporation," any shareholder, whether or not entitled to vote, may call such special meeting, with the same rights and powers as are provided in this Act for the call of a substitute annual meeting by a shareholder. At such special meeting, there shall be elected such number of directors as have been specified in the articles or the bylaws, if the articles or bylaws provided for the possibility of the corporation ceasing to qualify as a close corporation; and if no such number is specified, three (3) directors shall be elected.

Article 2.30-2, Agreement Among Shareholders of a Close Corporation

A. The shareholders of a close corporation may, by an agreement to which all the shareholders of the corporation, whether or not entitled to vote, have actually assented, regulate any phase of the business and affairs of the corporation or the relations of the shareholders, including, but not limited to, the following:

1. Management of the business and affairs of the corporation whether by a board of directors or one or more of the shareholders or one or more other parties to be selected by the shareholders;
2. Restriction on the transfer of shares or other securities;
3. Exercise or division of voting requirements or power;
4. Terms and conditions of employment of any shareholder, director, officer, or employee regardless of the length of time of such employment;
5. Persons who shall be directors and officers of the corporation;
6. Declaration and payment of dividends or division of profits;
7. Arbitration of issues as to which the shareholders are deadlocked in voting power or as to which the directors or other parties managing the corporation are deadlocked in the event the shareholders are unable to break the deadlock; or
8. Treatment of the business and affairs of the corporation as if it were a partnership or arrangement of the relations among the shareholders or between the shareholders and the corporation in a manner that would otherwise be appropriate only among partners.

B. To be valid, such shareholders' agreement either (1) shall be set forth in full in the articles of incorporation of the close corporation or incorporated by references therein by following the procedure prescribed in Section F, Article 2.19 of this Act, for incorporation by reference of restrictions on the transferability of shares; or (2) shall be set forth in the bylaws of the corporation or incorporated by reference therein, provided such bylaws and a counterpart of the agreement be placed on file by the corporation at its principal place of business and its registered office and shall be subject to the same right of examination by a shareholder of the corporation, in person, or by agent, attorney, or accountant, as are the books and
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records of the corporation. If the agreement is set forth or referred to in the original articles of incorporation, all the parties to the agreement shall serve as incorporators of the close corporation. If set forth or referred to in an amendment to the articles of incorporation, such amendment shall have been adopted by a vote of the holders of all outstanding shares, whether or not entitled to vote by the articles of incorporation. If set forth or referred to in the bylaws of the corporation either when originally adopted or later amended, such provisions of the bylaws shall have been adopted, amended, or ratified by a unanimous vote of the holders of all outstanding shares, whether or not entitled to vote by the articles of incorporation.

C. Each certificate representing shares of stock issued by a close corporation whose shareholders have entered into an agreement permitted by this Article shall (1) set forth conspicuously a full or summary statement of such agreement on the face of the certificate; or (2) set forth such statement on the back of the certificate and conspicuously refer to the same on the face of the certificate; or (3) if the agreement has been set forth in full in the articles of incorporation or incorporated by reference therein, conspicuously state on the face or back of the stock certificate that such shares are subject to an agreement among all the shareholders of the close corporation and that the corporation will furnish to the holder of the certificate without charge upon written request to the corporation at its principal place of business or registered office a copy of such agreement and that the provisions of such agreement are on file in the office of the Secretary of State; or (4) if the agreement has been set forth in full or incorporated by reference in the bylaws and a counterpart of the agreement placed on file by the corporation at its principal place of business and its registered office, conspicuously state on the face or back of the certificate that such shares are subject to an agreement among all the shareholders of the close corporation and that the corporation will furnish to the holder of a certificate without charge upon written request to the corporation at its principal place of business or registered office a copy of such bylaw or agreement. Unless noted conspicuously on the stock certificates in the manner prescribed above, such agreements even though otherwise enforceable among the parties thereto shall not be binding upon a transferee of such shares unless such transferee is a person with actual knowledge of the agreement, or such transferee acquired his shares by gift or bequest from a person who was a party to such agreement in which case such transferee shall be deemed to have actual notice thereof.

D. To the extent that it contains any provisions which would not be valid but for Section A of this Article, an agreement authorized by this Article shall be valid only so long as (1) no shares of the corporation shall have been issued by the corporation through any public offering, solicitation or advertisement; and (2) the corporation maintains its status as a close corporation as defined in Article 2.30-1 of this Act.

E. In the event a close corporation shall have a board of directors, the effect of an agreement authorized by this Article shall be to relieve the director or directors of, and to impose upon the shareholders who are parties to or are bound by the agreement and who voted for or assented to the transaction in question, the liabilities imposed by this Act or by law for action taken or neglected to be taken by directors to the extent that and so long as the discretion or powers of the directors in their management of corporate affairs is controlled by any such provision.

Article 2.30-3, Proceedings To Prevent Loss of Close Corporation Status or To Enforce Agreements Among Shareholders of a Close Corporation

A. Any close corporation as defined in this Act, a shareholder of such corporation, or a person who is party to or is bound by an agreement among shareholders of a close corporation, may file a petition in any court of competent jurisdiction in the county in which the close corporation has its principal place of business, to
have the court, if it shall deem the same equitable, issue all orders necessary to prevent the corporation from losing its status as a close corporation; or to 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 shareholder or any other person which would be inconsistent with its status as a close corporation; or to enforce by injunction, specific performance, or such other relief as the court may determine to be fair and appropriate in such circumstances, an agreement among shareholders of a close corporation permitted by Article 2.30-2 of this Act.

B. As an alternative to the granting of an injunction, specific performance or other equitable or legal relief in any proceeding brought under Section A of this Article, the court may, upon the motion of a party to the proceeding, order the appointment of a receiver for specific assets of the close corporation or to rehabilitate the close corporation, or order the liquidation of the assets and business of the close corporation, and decree its involuntary dissolution, as permitted by this Act, but only if the court shall find that the grounds for such receivership or liquidation and involuntary dissolution provided for in this Act exist.

C. Any court of competent jurisdiction in which a proceeding provided for in Section A may be brought may enjoin or set aside any transfer or threatened transfer of shares of stock of a close corporation which will adversely affect its status as a close corporation, or which is contrary to restrictions on the transfer of shares of such stock permitted by Article 2.22 of this Act, and may enjoin any public offering, public solicitation, or advertisement of shares of stock of the close corporation.

D. Nothing contained in this Article shall impair the power of any court of competent jurisdiction in any proceeding properly brought before it to enforce any restriction on the transfer of shares or other securities permitted by Article 2.22 of this Act or any agreement among any number of holders of the securities of a corporation or any number of the holders of such securities and the corporation not provided for in Article 2.30-2 of this Act and to grant whatever remedies may be properly available in such proceedings.

Article 2.30-4, Appointment of a Provisional Director for a Close Corporation in Certain Cases

A. Notwithstanding any contrary provision in the articles of incorporation, or bylaws, or agreement among shareholders of a close corporation, any close corporation as defined in this Act, a shareholder of such corporation, or a person who is a party to or who is bound by an agreement among shareholders of a close corporation, may file a petition in any court of competent jurisdiction in the county in which the corporation has its principal place of business to have the court appoint a provisional director for the close corporation when it is established that the directors, or the shareholders if they have been empowered to manage the business and affairs of the close corporation as permitted by this Act are so divided respecting the management of the corporation's business and affairs that the votes required for action by the board of directors, or the shareholders, as the case may be, cannot be obtained with the consequence that the business and affairs of the close corporation can no longer be conducted to the advantage of the shareholders generally.

B. A provisional director shall be an impartial person who is neither a shareholder nor a creditor of the corporation or of any subsidiary or affiliate of the corporation, and whose further qualifications, if any, may be determined by the court. A provisional director is not a receiver of the close corporation and does not have the powers and duties of receivers appointed under Articles 7.04-7.07 of this Act. A provisional director shall have all the rights and powers of a duly elected director of the close corporation, or the rights and powers of vote of a shareholder if management of the business and affairs of the close corporation has been vested
in its shareholders as permitted by this Act, including the right to notice of and to vote at meetings of directors or shareholders, as the case may be. A provisional director shall serve until removed by order of the court or by a vote of a majority of the directors, or the shareholders, as the case may be, or if the articles of incorporation require the concurrence of a greater majority for action by the directors, or the shareholders, as the case may be, then by that majority. The compensation of a provisional director shall be determined by an agreement between him and the close corporation subject to the approval of the court, which may fix his compensation in the absence of agreement or in the event of disagreement between the provisional director and the close corporation.

Article 2.30-5, Shareholders' Option To Dissolve Close Corporation
A. The articles of incorporation of any close corporation as defined in this Act may include a provision granting to any shareholder, or to the holders of any specified number or percentage of shares of any class of stock, an option to have the close corporation dissolved at will or upon the occurrence of any specified event or contingency. Whenever any such option to dissolve is exercised, the shareholders exercising such option shall give written notice thereof to all other shareholders. After the expiration of thirty (30) days following the sending of such notice, the dissolution of the close corporation shall proceed as if all its shareholders had consented in writing to dissolution of the corporation as provided in Article 6.02 of this Act.
B. Each certificate of shares of a close corporation whose articles of incorporation authorize dissolution as permitted by this article shall (1) set forth conspicuously a full or summary statement of such provision on the face of the certificate; or (2) set forth such statement on the back of the certificate and conspicuously refer to the same on the face of the certificate; or (3) shall conspicuously state on the face or back of the certificate that the corporation will furnish to any shareholder without charge upon written request to the corporation at its principal place of business or registered office and that there is on file in the office of the Secretary of State a full statement of the provision giving shareholders the option to dissolve the close corporation.