

12-1956

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Recommended Citation

F. Hodge O'Neal, Molding the Corporate Form to Particular Business Situations: Optional Charter Clauses, 10 *Vanderbilt Law Review* 1 (1956)

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F. Hodge O'Neal, Molding the Corporate Form to Particular Business Situations: Optional Charter Clauses, 10 VAND. L. REV. 1 (1956).

ALWD 7th ed.

F. Hodge O'Neal, Molding the Corporate Form to Particular Business Situations: Optional Charter Clauses, 10 Vand. L. Rev. 1 (1956).

APA 7th ed.

O'Neal, F. (1956). Molding the corporate form to particular business situations: optional charter clauses. *Vanderbilt Law Review*, 10(1), 1-54.

Chicago 17th ed.

F. Hodge O'Neal, "Molding the Corporate Form to Particular Business Situations: Optional Charter Clauses," *Vanderbilt Law Review* 10, no. 1 (December 1956): 1-54

McGill Guide 9th ed.

F. Hodge O'Neal, "Molding the Corporate Form to Particular Business Situations: Optional Charter Clauses" (1956) 10:1 Vand L Rev 1.

AGLC 4th ed.

F. Hodge O'Neal, 'Molding the Corporate Form to Particular Business Situations: Optional Charter Clauses' (1956) 10(1) *Vanderbilt Law Review* 1

MLA 9th ed.

O'Neal, F. Hodge. "Molding the Corporate Form to Particular Business Situations: Optional Charter Clauses." *Vanderbilt Law Review*, vol. 10, no. 1, December 1956, pp. 1-54. HeinOnline.

OSCOLA 4th ed.

F. Hodge O'Neal, 'Molding the Corporate Form to Particular Business Situations: Optional Charter Clauses' (1956) 10 Vand L Rev 1

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MOLDING THE CORPORATE FORM TO PARTICULAR BUSINESS SITUATIONS: OPTIONAL CHARTER CLAUSES

F. HODGE O'NEAL*

This paper looks into the usefulness of optional (or as they are sometimes called, "permissive" or "special") charter provisions¹ in molding the corporate form of business organization to meet the diverse needs of particular business situations.² It first examines statutory materials and judicial decisions bearing on the validity and effect of optional provisions. It then considers optional clauses in current use and typical legal and business problems that optional clauses may help to solve. It shows that optional clauses often can be used to clarify the rights and other relations of participants in an enterprise, to avoid disadvantageous corporate "norms," or to eliminate normal corporate attributes undesired in a particular enterprise. Finally, it discusses measures that increase the effectiveness of optional clauses and protect them against circumvention.

STATUTORY AND CASE LAW BASES FOR OPTIONAL PROVISIONS

The lawyer preparing a corporate charter should try to find clear statutory or judicial support for each clause he uses.³ He must study

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1. Corporation statutes list "mandatory" charter provisions, i.e., clauses that must be inserted in the articles of incorporation, certificate of incorporation or basic incorporation paper, whatever it may be called in a particular jurisdiction. Among the clauses which must be included in the charter are some (the stock and financial clauses, for instance) which are "optional" in the sense that the draftsman is not restricted to bare recitals of required items but has a wide choice as to the wording and content of the clauses he uses. The variations to which clauses of that kind are susceptible give the draftsman considerable leeway in molding the structure of a corporation to business needs. This paper, however, does not discuss clauses of that kind. It deals solely with charter clauses on matters which the statute does not require the draftsman to cover at all in the charter.

2. This subject is a relatively unexplored one. A good deal of law has grown up around optional provisions, but the statutes and cases have not been collected and analyzed with a view to providing a guide for practitioners engaged in planning and drafting corporate charters. For brief but helpful comments on optional clauses, see Aspey, *Suggestions and Precautions in Drafting Articles of Incorporation*, in ORGANIZING AND ADVISING SMALL BUSINESS ENTERPRISES (Cal. Practice Hand Book No. 2) 162, 171-75 (1954); BALLENTINE & STERLING, CALIFORNIA CORPORATIONS LAWS §§ 35-39 (1949 ed.); ISRAELS AND GORMAN, CORPORATE PRACTICE, 55, 107-09 (1955 rev.). For a collection of specimen clauses, see BALLENTINE & STERLING, *op. cit. supra* § 512.

3. Some cases have held that charter clauses "not responsive to some specifi-

the entire corporation act, because statutory materials that bear on the validity or effect of optional charter provisions may be scattered throughout the act.⁴

In many jurisdictions, authorization for the use of optional clauses in the charter is set forth in the same section of the corporation act that lists the mandatory charter provisions or in a section immediately following the mandatory provisions section. Even in these jurisdictions, however, the draftsman cannot safely ignore other parts of the act, because other sections may authorize additional optional clauses or specify with greater particularity the nature or scope of the clauses that may be used.⁵ Similarly, a general authorization of optional charter clauses may be narrowed⁶ by other provisions of the act.

The statutory materials that support the use of optional charter clauses can be classified as follows:⁷ (1) statutes specifically naming clauses (*e.g.*, clauses limiting or denying shareholders' preemptive rights) which may be included in the charter; (2) statutes stating rules to apply in the absence of coverage in the charter or otherwise indicating in a backhanded or indirect way that treatment of specified matters in the charter is permissible;⁸ (3) statutes authorizing in

cation in the law" will be disregarded as surplusage. See authorities discussed pp. 19-20 *infra*, especially those in note 98. BRUNE, MARYLAND CORPORATION LAW AND PRACTICE § 101 (rev. ed. 1953) refers to "dangerous consequences" which might follow reliance upon an invalid charter provision but does not specify what consequences he had in mind.

4. See *e.g.*, CAL. CORP. CODE ANN. §§ 305, 803(b), 817, 1103(b), 1107, 1707(c), 2214, 2466, 3033, 3600 (Deering 1953).

5. See, *e.g.*, UNIFORM BUSINESS CORPORATION ACT §§ 36(II), 31(III).

6. Consider, for example, the possible restrictive effect on KAN. GEN. STAT. ANN. § 17-2803(F) (1949) (authorizing a charter provision reserving to the corporation and existing shareholders the right to purchase and acquire the stock of a selling stockholder before sale to outsiders) of KAN. GEN. STAT. ANN. § 17-3004 (1949) (providing that a corporation may not purchase its own stock except in the situations there specified). For another statutory provision that may narrow the choice which at first sight appears to be given to the draftsman by more general statutory sections, see DEL. CODE ANN. tit. 8, § 153(a) (1953). See also CAL. CORP. CODE ANN. § 3003 (Deering 1953) (shareholders' right to inspect records cannot be limited by articles); CAL. CORP. CODE ANN. § 2466 (Deering 1953) ("The provisions of this section shall control although the charter or articles of incorporation . . . provide that the shares represented thereby shall be transferable only on the books. . . ."); OHIO REV. CODE ANN. § 1701.58 (Baldwin 1953) ("Such right to vote cumulatively shall not be restricted or qualified by the articles or the code of regulations").

7. See 1 FLETCHER, CORPORATION FORMS ANNOTATED § 179 (3d and rev. ed., Nichols 1938).

8. The wording of these statutes varies widely. Many statutes state the norm that is to apply "unless otherwise provided in the articles or by-laws." A few other examples of the statutory language follow: CAL. CORP. CODE ANN. § 805 (Deering 1953) (directors shall hold office until the next annual meeting "unless the articles provide for a shorter time"); CAL. CORP. CODE ANN. § 1103 (Deering 1953) ("subject to any limitations or restrictions contained in the articles"); CAL. CORP. CODE ANN. § 1107 (Deering 1953) (a corporation may, "upon such terms and conditions as the articles or by-laws may authorize," provide and carry out an employee stock purchase plan); N.Y. STOCK CORP. LAW § 5(12) (if meetings of the board of directors "are to be held only within the state the certificate or by-laws must so provide");

broad, vague terms the use of whatever lawful clauses the incorporators may choose to insert to regulate the conduct of corporate affairs or to define the powers of the corporation, the shareholders or the directors;⁹ and (4) statutes stating that any provisions may be inserted in the charter which are authorized for inclusion in the by-laws.¹⁰

Statutes of the first two types seldom present problems for the draftsman. Most of them indicate with reasonable clarity the nature and permissible scope of the particular charter provisions that they authorize. These two types of statutes are discussed together in this paper under the heading "Statutes Authorizing Specific Provisions," and the discussion is limited to a rather brief enumeration of the clauses for which specific authority is to be found in the statutes. The broad, vague language of statutes of the third type raises many questions of interpretation. Those statutes and the judicial decisions applying or interpreting them are examined in some detail under the heading "Broadly Worded Statutes and Decisions Interpreting Them." The fourth type of statute obviously calls for an inquiry into what matters are within the purview of the by-laws. This paper does not go into that question.¹¹

A. Statutes Authorizing Specific Provisions.

The number and kinds of optional clauses that are specifically authorized by statute vary tremendously from state to state; in most jurisdictions, however, only two or three clauses, if that many, are thus authorized.¹² Perhaps the charter clause for which express statutory support can be found in the greatest number of jurisdictions is one "limiting or denying" shareholders' preemptive rights to subscribe to new issues of stock.¹³ Other optional clauses which are expressly and specifically authorized in a considerable number of

WYO. COMP. STAT. ANN. § 44-117 (1945) ("the directors, if the certificate of incorporation so provides, shall have power to make by-laws").

9. Statutes of this kind are discussed pp. 5-19 *infra*.

10. See, e.g., MD. ANN. CODE art. 23, § 4(c) (1951).

11. For considerations to keep in mind in deciding whether to place a particular provision in the charter or the by-laws, see pp. 46-51 *infra*.

12. A few corporation statutes, however, specifically authorize a rather large number of optional clauses. See, e.g., OHIO REV. CODE ANN. §§ 1707-47, 1701.48(c), 1701.63, 1701.65, 1701.67, 1701.68 (Baldwin 1953).

13. See, e.g., DEL. CODE ANN. tit. 8, § 102(b) (3) (1953); KAN. GEN. STAT. ANN. § 17-2803(D) (1949); MINN. STAT. ANN. § 301.04(9) (Supp. 1955); NEB. REV. STAT. § 21-106 (1943); OREG. REV. STAT. § 57.311 (1953); W. VA. CODE ANN. § 3018(1) (1955). See also LA. REV. STAT. § 12-3(B)(1) (1950) ("enlarging, limiting or denying"); MD. ANN. CODE art. 23, § 26 (1951) (preemptive rights may be "defined, limited or denied"). "The articles . . . may provide that the shareholders shall have no pre-emptive right to subscribe for any additional shares of capital stock or other obligations convertible into shares to be issued by the corporation or may provide any restrictions or limitations on such rights as may be desired." MICH. COMP. LAWS § 450.31 (1948). On the other hand the statutes in some states authorize optional charter provisions "granting" preemptive rights. E.g., CAL. CORP. CODE ANN. § 305(b) (Deering 1953); PA. STAT. ANN. tit. 15, § 2852-204(11).

jurisdictions include: restrictions on the transferability of stock,¹⁴ provisions requiring for director action a greater than majority vote or requiring for shareholder action the vote of larger proportion of the stock or of any class of stock than would otherwise be necessary,¹⁵ provisions setting high quorum requirements for shareholders' and directors' meetings,¹⁶ provisions (set forth verbatim in the statute) relating to compromises and arrangements,¹⁷ and clauses conferring on directors the power to make by-laws.¹⁸

Section 9 of the New York Stock Corporation Law¹⁹ is perhaps the best known of the statutory provisions specifically authorizing use of a particular kind of special charter clause. That statute provides that (subject to compliance with specified requirements of consent by shareholders) the certificate of incorporation can impose high quorum requirements for shareholders' meetings and for directors' meetings, and can require unanimity or a vote greater than a majority for shareholder and director action.²⁰

Other optional provisions which are expressly authorized in one or more jurisdictions are as follows: clauses vesting in the board of directors authority to establish series of shares and to fix the variations in the relative rights and preferences as between series,²¹ clauses providing that a particular class or classes of shares or securities may

14. *E.g.*, KAN. GEN. STAT. ANN. § 17-2804(F) (1949) (provision reserving to the corporation and existing shareholders the right to purchase and acquire the stock of a selling stockholder before sale to a non-stockholder); MD. ANN. CODE art. 23, § 6 (1951); R. I. GEN. LAWS 1938, c. 116, art. I, § 7 (charter clauses providing that the corporation shall have a lien on the shares of a holder for assessments due from him or for other indebtedness due the corporation, or that the corporation shall have the right on the sale of stock by any holder to purchase the stock at the lowest price at which the holder is willing to sell before it is offered to any other purchaser).

15. *E.g.*, CAL. CORP. CODE ANN. § 817 (Deering 1953); DEL. CODE ANN. tit. 8, § 102(b)(4) (1953); KAN. GEN. STAT. ANN. § 17-2803(G) (1949); NEB. REV. STAT. § 21-106 (1934); OHIO REV. CODE ANN. § 1701.55 (Baldwin 1953); W. VA. CODE ANN. § 3018(j) (1955). For a discussion of these and similar statutory materials see O'Neal, *Giving Shareholders Power to Veto Corporate Decisions: Use of Special Charter and By-Law Provisions*, 18 LAW & CONTEMP. PROB. 451, 457-59 (1953).

16. See, *e.g.*, MO. REV. STAT. §§ 351.265, 351.325 (1949); N.Y. STOCK CORP. LAW § 9; OHIO REV. CODE ANN. § 1701.67 (Baldwin 1953); ORE. REV. STAT. §§ 57.165, 57.200 (1953); WIS. STAT. §§ 180.28, 180.35 (1955).

17. See, *e.g.*, DEL. CODE ANN. tit. 8, § 102(b)(2) (1953); KAN. GEN. STAT. ANN. § 17-2803(C) (1949); MICH. COMP. LAWS § 450.4(3) (1948); W. VA. CODE ANN. § 3018(h) (1949).

18. See, *e.g.*, VA. CODE ANN. § 13-10 (1950); UNIFORM BUSINESS CORPORATIONS ACT § 26(II); WYO. COMP. STAT. ANN. § 44-117 (1945). See also KAN. GEN. STAT. ANN. § 17-2803(H) (1949) (authorizing a charter clause setting forth the manner of adopting, altering and repealing by-laws).

19. N.Y. STOCK CORP. LAW § 9.

20. Section 9 originally limited the effectiveness of charter provisions of this kind to ten years, after which they could be renewed for one or more ten year periods. N.Y. Sess. Laws 1951, c. 717 § 1, which amends Section 9, apparently permits clauses effective for an unlimited period of time.

21. See, *e.g.*, ILL. ANN. STAT. c. 32, § 157.47 (Smith-Hurd 1954). See also KAN. GEN. STAT. ANN. § 17-2802(f) (1949).

elect a specified number or proportion of the directors,²² statements that directors must be residents of the state of incorporation or shareholders in the corporation,²³ provisions that only directors elected by the vote of a particular class or classes or shares or securities may elect all or designated officers,²⁴ statements fixing the terms of the directors at less than one year,²⁵ provisions authorizing any director or shareholder to vote for an absent director in accordance with the latter's written instructions,²⁶ provisions setting forth the method and conditions upon which members shall be accepted, discharged or expelled,²⁷ clauses granting power to levy assessments upon shares,²⁸ provisions that no shareholder shall own or vote more than a specified percentage of the corporation's stock,²⁹ clauses setting up an employee stock purchase plan,³⁰ provisions denying or limiting the power of the board of directors to fix a time in the future as record date for determining shareholders of record entitled to vote or to an allotment or distribution,³¹ provisions limiting the power of the corporation to purchase its shares from earned surplus,³² provisions fixing the consideration for which no-par shares may be issued by the incorporators,³³ provisions setting the valuation of consideration to be received for shares,³⁴ and provisions that the corporation may pay dividends from the net profits arising from wasting assets without deducting for depreciation or depletion.³⁵

B. Broadly Worded Statutes and Decisions Interpreting Them.

The draftsman will usually find that some of the optional clauses he wants to use are not referred to individually or specifically in the corporation statute. In most states, as has been mentioned,³⁶ only two or three clauses receive specific statutory sanction; and generally the clauses specifically authorized are not the ones most often used. Thus, the draftsman frequently has to look to broadly worded statutory

22. LA. REV. STAT. § 12:34 (1950).

23. ILL. ANN. STAT. c. 32, § 157.33 (Smith-Hurd 1954). See also CAL. CORP. CODE ANN. § 804 (Deering 1953).

24. LA. REV. STAT. § 12:34(D) (1950).

25. CAL. CORP. CODE ANN. § 805 (Deering 1953).

26. LA. REV. STAT. § 12:35(F) (1950).

27. WIS. STAT. § 180.02(g) (1947). This provision omitted from 1955 Code. See WIS. STAT. 180.45 (1955).

28. CAL. CORP. CODE ANN. § 305 (Deering 1953). See also KAN. GEN. STAT. ANN. § 17-2803(A) (1949).

29. KAN. GEN. STAT. ANN. § 17-2803(E) (1949). See also UNIFORM BUSINESS CORPORATION ACT § 28(I) ("Except as otherwise provided in the articles of incorporation, every shareholder of record shall have the right . . . to one vote for every share standing in his name on the books of the corporation").

30. CAL. CORP. CODE ANN. § 1107 (Deering 1953).

31. CAL. CORP. CODE ANN. § 2214 (Deering 1953).

32. CAL. CORP. CODE ANN. § 1707(c) (Deering 1953).

33. OHIO REV. CODE ANN. § 1701.06(f) (Baldwin 1953).

34. OHIO REV. CODE ANN. § 1701.06(g) (Baldwin 1953).

35. LA. REV. STAT. § 12:3(C) (1950).

36. See p. 3 *supra*.

materials for support for clauses that he wants to insert in the charter.

(1) *The Statutes*.—Most corporation statutes contain a section which in broad terms authorizes the use of optional provisions in the charter.³⁷ Some statutes list the required contents of the charter and then simply add a statement that the charter may contain "any provisions not inconsistent with law, which the incorporators may choose to insert for the regulation of the internal affairs of the corporation,"³⁸ or a statement something to that effect.³⁹ The section in the Delaware statute,⁴⁰ which has substantially identical or very similar counterparts in a number of jurisdictions,⁴¹ is somewhat more lengthy. It states that the charter may contain:

37. The corporation laws of a number of states have contained since the beginning of this century a section broadly authorizing the use of optional charter provisions. See, e.g., Ala. Gen. Acts 1903, act 395, § 2(j); N.Y. Sess. Laws 1895, c. 672, § 10; N.C. Pub. Laws 1901, c. 2, § 8(7); Va. Acts of Assembly, Extra Session 1902-1904, c. 270, at 437. The National Banking Act of 1864 contained a section of this kind. See *Bullard v. Bank*, 85 U.S. (18 Wall.) 589 (1874). One of the reasons for enacting these statutes authorizing optional charter provisions was to enable persons entering closely held corporations as minority shareholders to protect themselves by insisting on appropriate charter clauses against increases in capital stock, increases in the number of directors, consolidations and other changes in the structure or management of the corporation which might adversely affect their rights. "It was to enable parties to incorporate without being subject to these dangers that the statute of 1895 was enacted to permit the parties in interest, by their original agreement of incorporation, to limit their respective rights and powers in respects that did not affect the public." *Ripin v. United States Woven Label Co.*, 205 N.Y. 442, 98 N.E. 855, 856-57 (1912). The applicability of the statutes, however, was not confined to closely held corporations.

38. E.g., PA. STAT. ANN. tit. 15, § 2852-204(12). See also ILL. ANN. STAT. c. 32, § 157.47 (Smith-Hurd 1954).

39. See ALA. CODE ANN. tit. 10, § 2(10) (1940); CONN. GEN. STAT. § 5153 (1949). MASS. ANN. LAWS c. 156, § 6 (1948), after setting forth the clauses which the agreement of association must have, adds that it may contain any other "lawful provision for the conduct and regulation of the business of the corporation, for its voluntary dissolution, or for limiting, defining or regulating the powers of the corporation, or of its directors or stockholders, or of any class of stockholders." See also R. I. GEN. LAWS 1938, c. 116, art. I, § 8 (very similar to Massachusetts statute but substitutes "provisions not inconsistent with law" for "lawful provisions" and omits "for its voluntary dissolution"). The language of some statutes is perhaps even broader and more inclusive. See, e.g., MO. REV. STAT. § 351.055 (1949) (provisions "not inconsistent with law, which the incorporators may choose to insert"); UTAH CODE ANN. § 16-2-5(12) (1953) ("such additional clauses as the incorporators deem necessary for conducting the business of the corporation and for its future safety and welfare"); WIS. STAT. § 180.45(2) (1955) ("include additional provisions, not inconsistent with law, including any provision which under this chapter is required or permitted to be set forth in the by-laws.")

40. DEL. CODE ANN. tit. 8, § 102(b) (1) (1953).

41. See ARK. STAT. ANN. 64-101(i) (1947) (identical with the Delaware provision except that "for the regulation of the business" is used in lieu of "for the management of the business" and "dividing" is used in lieu of "defining"); FLA. STAT. ANN. § 608.03 (Supp. 1955) (same as the Arkansas statute except that the proviso is eliminated and the following substituted: "including, but not limited to, a list of officers, and provisions governing the issuance of stock certificates to replace lost or destroyed stock certificates"); GA. CODE ANN. § 22-1802(h) (Supp. 1951) (varying in a number of respects from the Delaware section, including the addition of the clause "and creating, defining or limiting the preferences or rights given to any particular class of the stock"); KAN. GEN. STAT. ANN. § 17-2803(B) (1949) (identical with Delaware statute); MD. ANN. CODE art. 23, § 4(b) (9) (1951) ("any provision

Any provision which the incorporators may choose to insert for the management of the business and for the conduct of the affairs of the corporation, and any provisions creating, defining, limiting and regulating the powers of the corporation, the directors and the stockholders, or any class of the stockholders, or, in the case of a corporation which is to have no capital stock, of the members of such corporation; provided, such provisions are not contrary to the laws of this state.

Just exactly what optional charter provisions are sanctioned by these broadly worded statutes is difficult to determine.⁴² The few judicial decisions that have interpreted these statutes are not entirely in accord, and a number of the decisions invalidate charter clauses that the broad, general language of the statutes (at least if taken literally) clearly seems to authorize. Further, the facts that the statutes vary somewhat from state to state weakens the authority of these decisions in other jurisdictions; and even under identical statutes differences in other parts of the corporation law or in judicial conceptions of what constitutes an appropriate corporate structure may lead to disparate results.

As the statutes vary from jurisdiction to jurisdiction, and as many

not inconsistent with law, which may be desired for the purpose of defining, limiting and regulating the powers of the corporation and of the directors and stockholders, or of any class of stockholders, and of holders of any bonds, notes or other securities which the corporation may issue"); MICH. COMP. LAWS § 450.4(2) (1948) (deviates from language of Delaware section considerably and in addition gives authority for provisions "for the purpose of creating and defining rights and privileges of the shareholders among themselves."); N.J. REV. STAT. § 14:2-3 (1937) (any provision, "consistent with law, which the incorporators may choose to insert, for the management of the business and the conduct of the affairs of the corporation, and any provision creating, defining, limiting and regulating the powers of the corporation, its directors and stockholders or any class of stockholders."); W. VA. CODE ANN. § 3018(g) (1955) (identical with Delaware section except that "provided" is capitalized and is preceded by a colon rather than a semi-colon. N.Y. GEN. CORP. LAW § 13(2) provides that the certificate of incorporation of a corporation may contain "any provision for the regulation of its business and the conduct of its affairs, and any limitation upon its powers, or upon the rights of its stockholders or upon the powers of its directors and members, which does not exempt them from the performance of any obligation or duty imposed by law."

OHIO REV. CODE ANN. § 1701.06 (Baldwin 1953) provides that the articles of incorporation shall set forth

"(H) Any lawful provisions which may be desired for the purpose of defining, limiting, and regulating the exercise of the authority of the corporation, of the directors, or of all of the share-holders; any provision which may be made in the code of regulations of a corporation may be made in its articles;

"(I) Such additional provisions permitted by sections 1701.01 to 1702.43, inclusive, of the Revised Code, as may be desired."

The statutory sections referred to in (I) take in the whole of the Ohio general corporation statute. Note also that (H) and (I) are cumulative.

42. Some authors caution against a too ready reliance on these statutes for support of charter clauses. See BALLANTINE, CORPORATIONS § 16 (rev. ed. 1946); BALLANTINE AND STERLING, CALIFORNIA CORPORATION LAWS § 37 (1949 ed.) Professor Ballantine may have been influenced in his views by the language of the California statute, which is somewhat narrower than that of statutes in many jurisdictions.

of the decisions interpreting them are questionable or are based in part at least on other statutory materials, each decision must be considered individually and in some detail to determine what weight to give it in another jurisdiction.

This paper now discusses decisions relating to the scope of the authorization (*i.e.*, determining what charter clauses are included within the coverage of the statute), the New York cases of this kind being grouped and discussed separately from the others. It then considers the cases interpreting provisos and other language in the statutes which except from the broad authorization charter provisions contrary to law.

(2) *The Cases Outside New York.*—Perhaps the first decision to construe one of these general statutes was *Bullard v. The National Eagle Bank*.⁴³ In that case, the United States Supreme Court had before it a section of the National Banking Act of 1864⁴⁴ which provided that articles of association of national banks might contain any provisions "not inconsistent with the provisions of this Act, which the Association may see fit to adopt for the regulation of the business of the Association and the conduct of its affairs." The court held that this statutory provision did not authorize a clause in the bank's articles of association giving the directors power to make by-laws prohibiting the transfer of stock owned by a holder indebted to the bank. This charter clause, the Court stated, "ought not to be considered as a regulation of the business of the Bank or a regulation for the conduct of its affairs."⁴⁵ The Court, however, seemed to base its decision principally on Congress' repeal of an earlier statutory provision which had stated that shareholders indebted to a national bank could not transfer their stock, the Court reasoning that this repeal manifested intention to withhold from banks a lien on stock of their debtors.

The next decision was *Audenried v. East Coast Milling Co.*,⁴⁶ which interpreted the following New Jersey statute:

The certificate of incorporation may also contain any provision which the incorporators may choose to insert for the regulation of the business, and for the conduct of the affairs of the corporation; and any provision creating, defining, limiting or regulating the powers of the corporation, of the directors, or of the stockholders, or of any class or classes of stockholders; provided, such provision be not inconsistent with this act.

The New Jersey court held that this broad statute did not authorize a charter provision that written resolutions signed by all directors would constitute board action, just as though they were passed at a

43. 85 U.S. (18 Wall.) 589 (1874).

44. 13 STAT. 100 (1864).

45. 85 U.S. (18 Wall.) at 596.

46. 68 N.J. Eq. 450, 59 Atl. 577 (Ch. 1904).

regularly called board meeting. Focusing on that part of the statute authorizing charter provisions "creating, defining, limiting, and regulating" the powers of the directors, the court drew a distinction between "creating" powers in the directors and setting up a procedure for exercising those powers. The legislature granted the right to create powers in the directors by special charter provision, said the court, not the "right to authorize the directors to exercise the powers thus established according to any method the incorporators may see fit to adopt."⁴⁷ The court further pointed out that other sections of the corporation statute stated that "the business of every corporation shall be managed by its board of directors" and that votes by the directors shall be recorded by the secretary in a book kept for that purpose, and reasoned that these statutory provisions (which it treated as mandatory norms) and common law concepts requiring directors to act as a board at deliberative meetings precluded charter authorization of separate action by the directors.

A Virginia act, identical with the New Jersey statute just discussed, was interpreted much more liberally. In *Union Trust Co. of Maryland v. Carter*,⁴⁸ a federal circuit court upheld a charter clause vesting in the board of directors entire control of the corporation for a period of approximately five and one-half years, and depriving shareholders of the right to vote or in any way participate in management during that period.⁴⁹ The effect the court gave norms in other parts of the corporation act was entirely different from that given in the *Audenried* case. It treated other sections of the act, such as those providing for annual meetings of the shareholders, for shareholder meetings at any time on call of ten percent of the shares, and for the board of directors to be under the direction of the shareholders, as applicable only to companies without charter provisions to the contrary.

In *News-Register Co. v. Rockingham Pub. Co.*,⁵⁰ Virginia's Supreme Court of Appeals found the statute adequate support for a charter amendment empowering the corporation to enter into a contract of partnership.⁵¹ The Virginia court, taking a view of the statute entirely different from that of the *Audenried* court, commented that it seemed "to clear for argument that the words, 'creating and defining,' as used in the statute are amply broad to provide for authority in the charter

47. 68 N.J. Eq. 450, 59 Atl. 577, 584 (Ch. 1904).

48. 139 Fed. 717 (C.C.W.D. Va. 1905).

49. Statements to this effect were also placed in the subscription contracts and on the share certificates. For a discussion of the desirability of referring on the share certificates to unusual charter provisions, see p. 52 *infra*.

50. 118 Va. 140, 86 S.E. 874 (1915).

51. The court stated, "If support be needed for this conclusion it is found in the construction placed upon the same provision in New Jersey by the text-writers and courts of that state." 86 S.E. at 877. Apparently the *Audenried* case was not brought to the court's attention.

of any private business corporation . . . to do any act not unlawful in itself and not prohibited by the statute."⁵²

(3) *The New York Cases*.—A number of decisions have interpreted and applied the New York statute, but taken together they do little to clarify its meaning. The first New York case was *People ex rel. Barney v. Whalen*.⁵³ At that time, the pertinent part of the New York statute read as follows:⁵⁴

The certificate may contain any other provision for the regulation of the business and the conduct of the affairs of the corporation and any limitation upon its powers and upon the powers of its directors and stockholders which does not exempt them from any obligation or from the performance of any duty imposed by law.

The Appellate Division held that this section did not sanction a charter clause empowering the directors, with the consent of holders of two-thirds of the stock, to dispose of all corporate property except franchises. The court concluded that the charter clause did not regulate the business or relate to the conduct of the affairs of the corporation within the meaning of the statute but on the contrary was one "for the purpose of ending or closing up its business or affairs,"⁵⁵ and that the clause did not limit the powers of the corporation or its directors and shareholders but instead enlarged those powers.

The statute came before the New York Court of Appeals in *Ripin v. United States Woven Label Co.*⁵⁶ On the basis of the statute, the court in that case upheld as valid and binding a provision in the certificate of incorporation that the number of directors fixed in the certificate could only be changed by unanimous shareholder consent. The court was not daunted by another section of the statute which stated that the number of directors in a corporation may be increased or reduced by the holders of a majority of the shares. Statutory rules of that kind, the court said, prescribe details of internal management intended to prevail in the absence of agreement to the contrary; they do not involve public policy and therefore can be modified by charter provisions. The court observed that the statute authorizing optional charter provisions would be of little or no efficacy unless it were interpreted to allow the incorporators to set regulations for the conduct of corporate affairs and limitations on the powers of the corporation and its

52. 86 S.E. at 877.

53. 119 App. Div. 749, 104 N.Y. Supp. 434 (3d Dep't), *aff'd mem.*, 189 N.Y. 560, 82 N.E. 1131 (1907).

54. N.Y. Sess. Laws 1892, p. 2042, c. 691, as amended by N.Y. Sess. Laws 1895, p. 445, c. 671, N.Y. Sess. Laws 1896, p. 314, c. 369, § 1, *Id.* p. 428, c. 460, and N.Y. Sess. Laws 1901, p. 1279, c. 520. Substantially the same provision was also contained in the New York General Corporation Law. N.Y. Sess. Laws 1892, p. 1804, c. 687, as amended by N.Y. Sess. Laws 1895, p. 449, c. 672.

55. 104 N.Y. Supp. at 556.

56. 205 N.Y. 442, 98 N.E. 855 (1912).

members different from those prescribed by the various sections of the corporation act.⁵⁷

The *Whalen* case was distinguished by pointing out that the charter clause in that case increased (rather than limited) the powers of the corporation and its directors and that therefore the provision there was clearly not supported by a statute which authorizes only "limitations" on the powers of the corporation or its directors or shareholders.⁵⁸ This distinction greatly weakens the *Whalen* case as an authority in other jurisdictions, because the statutes of most states expressly authorize charter provisions "creating, defining and regulating" (as well as "limiting") the powers of the corporation, directors or shareholders.⁵⁹

Earlier cases holding by-laws invalid as in conflict with rules laid down in the corporation act were distinguished in the *Ripin* case on the ground that the statutory grant to corporations of power to enact by-laws was restricted to by-laws "not inconsistent with any existing law." This restriction on by-laws apparently was considered to be broader and more inclusive than the limitation on charter provisions, which (it will be recalled) restricts approval to those clauses which

57. 98 N.E. at 856. The privilege would certainly be of little value if the court filled whatever "gaps" there might be in the statutes by "reading into" them common law concepts and rules. See *Audenried v. East Coast Milling Co.*, 68 N.J. Eq. 450, 59 Atl. 577 (Ch. 1904), discussed p. 8 *supra*. "The powers of the directors are conferred to enable the business of the corporation to be transacted in the interest of and for the profit of the stockholders. If the stockholders by charter or by by-law deem any limitation desirable there seems never to have been any reason for denying such right to them. But all doubt upon that score is set at rest by the provision of Section 10, subdivision 2, of the General Corporation Law [authorizing optional charter clauses] . . . [and] by Section 11, subdivision 5 [providing that duly adopted by-laws shall control the action of the directors]." *Farmers' Loan & Trust Co. v. Pierson*, 222 N.Y. Supp. 532, 546-47 (Sup. Ct. 1927). In *People ex rel. Manice v. Powell*, 201 N.Y. 194, 94 N.E. 634, 637 (1911) the court indicated that "reasonable and lawful" charter provisions authorizing the suspension or removal of a director would be given effect. At about this same time, however, the Attorney General of New York ruled a number of charter provisions invalid. *Ops. ATT'Y GEN.* 600 (N.Y. 1911) held that the Department of State did not have to file a certificate of incorporation which contained a clause requiring the shareholders of the corporation to sell to it all milk produced on their farms. "This," the Attorney General said, "is neither the regulation of the business of the corporation nor related to the conduct of its affairs. It is not a limitation of the powers of the stockholders, but it is in a sense a restraint upon the freedom to contract for the sale of their milk. Under no circumstances can I see any reason for its insertion in the charter." *Ops. ATT'Y GEN.* 238 (N.Y. 1912) declared invalid provisions in a certificate of incorporation which gave corporate creditors (1) the right to determine whether premises owned by the corporation should be sold, mortgaged or otherwise disposed of or encumbered, and (2) the right to determine whether the business of the corporation should be discontinued and its affairs liquidated.

58. 93 N.E. at 857. That the statute permitted charter limitations on the powers of the corporation and its directors or shareholders but not clauses creating or defining those powers is probably attributable to the fear which once prevailed that corporations might gain too much power if given free scope.

59. See pp. 6-7 *supra*.

do not exempt directors or shareholders from "any obligation or from the performance of any duty imposed by law."⁶⁰ In many jurisdictions, the statutory section authorizing optional charter clauses contains language similar to that used in the New York by-law limitation. In those states, the *Ripin* case might be persuasive authority against rather than in favor of the validity of a charter clause requiring shareholder unanimity to change the number of directors fixed in the certificate.

*In re Boulevard Theatre & Realty Co.*⁶¹ held invalid a charter provision which required unanimous consent of shareholders to elect directors. The Appellate Division said that the provision violated a section of the corporation act which declared that directors of "every stock corporation shall be chosen" by a plurality of shareholder votes. In holding that the section was mandatory, the court relied heavily on cases invalidating by-laws departing from the norm set by this statute. The *Ripin* case, which (it will be recalled) refused to extend decisions invalidating by-laws to charter provisions, was distinguished on the ground that the statutory section departed from by the charter clause in the *Ripin* case was permissive (providing that the number of directors "may" be increased or reduced when the shareholders so determine) while the section breached in the *Boulevard Theatre & Realty Co.* case was couched in imperative language.

A number of comments can be made on *In re Boulevard Theatre & Realty Co.* First, the court there invalidated a charter provision that did not exempt the directors or shareholders from the performance of any "obligation" or "duty" imposed by law, at least not in the ordinary meaning of those terms. The charter provision there (like the one in the *Ripin* case) can better be described as limiting a "power" of the shareholders. Thus the court in effect read into the optional charter provision section of the New York law a limitation or proviso expressly stated in the statutes of many jurisdictions, namely, that charter clauses cannot depart from norms laid down in other sections of the corporation act. Further, the court seemed to be of the opinion that a charter provision is invalid if it is inconsistent with a common law rule, particularly if the common law rule is "reinforced" by statute.⁶² Finally, after noting that many shareholders had submitted affidavits that until this controversy arose they were unaware of the existence of the special charter provision, the court intimated that a charter provision could be held invalid as contrary to public policy,

60. The Appellate Division clearly indicated that it considered the charter clause in the *Ripin* case only limited a power of the shareholders and did not exempt them from the performance of any of their duties. 145 App. Div. 916, 130 N.Y. Supp. 20, 21 (1st Dep't 1911).

61. 195 App. Div. 518, 186 N.Y. Supp. 430 (1st Dep't), *aff'd mem.*, 231 N.Y. 615, 132 N.E. 910 (1921).

62. 118 N.Y. Supp. at 433.

at least if the effect of the provision was "to work a fraud upon the public."⁶³ That the court was influenced by the fact that some of the shareholders were not aware of the charter clause certainly indicates the desirability of referring to unorthodox charter clauses on the share certificates.

*Albrect, Maguire & Co. v. General Plastics, Inc.*⁶⁴ added further confusion. In that case, a charter amendment cutting off the preemptive right of shareholders to purchase new issues of stock was approved by the holders of more than two-thirds of the shares. The court held that in view of the statute authorizing optional charter clauses,⁶⁵ the certificate of incorporation could be amended to deprive consenting shareholders of preemptive rights but that the amendment would not be effective against shareholders who voted against its adoption.⁶⁶ Thus, a charter amendment, approved by the required shareholders vote, was given effect as to some shareholders but not as to others. This case certainly points up the desirability of getting unanimous consent to the inclusion of optional provisions in the charter, particularly if they are of an uncommon kind, and of making certain that shareholders who come into the corporation later are aware of the provisions and consent to be bound by them.⁶⁷

(4) *Statutory Language Limiting Authorization to "Legal" Clauses.*—Most of the broad statutes authorizing optional charter clauses limit the authorization to "lawful" provisions, to provisions "consistent with the laws of this state," or to provisions which do not exempt the directors or shareholders "from the performance of any obligation or duty imposed by law."⁶⁸ The California law contains a sort of double requirement of legality. That statute⁶⁹ provides that the charter may include any desired clauses imposing "any limitations and requirements authorized by this division, and otherwise regulating the busi-

63. *Ibid.*

64. 256 App. Div. 134, 9 N.Y.S.2d 415 (4th Dep't), *aff'd mem.*, 280 N.Y. 840, 21 N.E.2d 887 (1939).

65. By the time of this case that statute was designated (as it is at present): N.Y. GEN. CORP. LAW § 13 (2).

66. The court did not indicate whether the amendment would be effective against shareholders who were not represented at the meeting or who were present or represented but did not vote.

67. See p. 44 *infra*.

68. In some of the statutes, this limitation is in the form of a "proviso." See, e.g., ALA. CODE ANN. tit. 10, § 2 (1940); KAN. GEN. STAT. ANN. § 17-2803 (B) (1949). Usually the limiting language, whether it be in the form of a restrictive adjective or adjectives or in the form of a proviso, applies to the whole statutory section. See e.g., LA. REV. STAT. § 12:3 (2), (3) (1950). In a few statutes, there is some doubt whether the limiting language applies to all clauses of the section. See, e.g., GA. CODE ANN. § 22-1802 (Supp. 1951); VA. CODE ANN. § 13-24(9) (1950). One or two statutes do not contain a limitation. See, e.g., UTAH CODE ANN. § 16-2-5(12) (1953). Does a statute without a limitation authorize charter clauses which would not be approved under statutes with a limitation? If so, what types of charter clauses?

69. CAL. CORP. CODE ANN. § 305(c) (Deering 1953).

ness and affairs of the corporation and the powers of the directors and shareholders *in a manner not in conflict with law.*"⁷⁰

These vague requirements of "lawfulness" invite attack on an unorthodox optional charter clause on the theory that it is contrary to a section of the corporation act or some other statute,⁷¹ is inconsistent with the statutorily established scheme of corporate organization, or is violative of some perhaps obscure public policy.

The question most often raised is whether a charter clause is inconsistent with a section of the corporation statute. The statutory section invoked to challenge a charter provision is usually a so-called "norm." It might state, for example, that the corporation shall be managed by the board of directors, that corporate officers shall be selected by the board of directors, or that specified corporate action can be taken on a designated percentage vote of the directors or shareholders. If variation from the norm by charter provision is not clearly authorized by the section containing the norm or by some other part of the corporation statute, a court is confronted by a difficult problem of statutory construction, really by a double problem of interpretation. First, the court should determine whether the statutory rule was meant to be definitive or was merely intended to govern in the absence of other arrangement among the participants. If the court concludes that the participants as a general proposition are not privileged to depart from the rule (say, in a shareholder's agreement or in the by-laws), then it should decide whether the broad statutory section authorizing optional charter provisions nevertheless permits departures from the norm by this specifically approved method, namely, the insertion of optional clauses in the charter.

The courts have not followed this somewhat refined approach. They simply classified a provision of the corporation statute as "mandatory" or "directory," and if they concluded that the provision is mandatory, they invalidate charter clauses that deviate from it. That the corporation statute also contains a section broadly authorizing optional charter provisions does not change the result. In only one decision⁷² has a court indicated that this broad authorization of optional charter clauses would support a clause deviating from a statutory norm which otherwise might be interpreted as mandatory. Numerous decisions have invalidated a charter clause on the ground that it contravened a mandatory statute.⁷³

70. Italics supplied.

71. A charter provision that violates the state constitution is of course void. *Van Pelt v. Gardner*, 54 Neb. 701, 75 N.W. 874 (1898).

72. *Ripin v. U. S. Woven Label Co.* 205 N.Y. 442, 98 N.E. 855, 856-57 (1912). In this case, the court on the basis of the general statutory provision authorizing optional charter provisions sustained a clause which it indicated it probably would have invalidated as a by-law.

73. The following cases have held statutory sections to be mandatory and

Some courts have expressed great indignation at a charter departure from a statutory norm, condemning it as a "fraud on the statute"⁷⁴ or as "subversive of the statute."⁷⁵ However, they seldom state what harm they think may result from the deviating charter clause. A few courts seem to have vague fears of encouraging some sort of corporate excesses if organizers are given much freedom in framing charters. A rather important objection was raised in *In re Boulevard Theatre & Realty Co.*⁷⁶ There the court declared that to sustain a charter pro-

have invalidated charter clauses which the courts considered inconsistent: *State ex rel. Ross v. Anderson*, 31 Ind. App. 34, 67 N.E. 207 (1903) (a charter provision naming permanent directors held obnoxious to statute making directors elective each year); *In re Boulevard Theatre & Realty Co.*, 195 App. Div. 518, 186 N.Y. Supp. 430 (1st Dep't 1921) (charter provision requiring unanimous shareholder vote for election of directors held inconsistent with statute calling for a plurality); *People ex rel. Barney v. Whalen*, 119 App. Div. 749, 104 N.Y. Supp. 555 (3d Dep't), *aff'd mem.*, 189 N.Y. 560, 82 N.E. 1131 (1907) (charter clause giving the directors authority, with the consent of the holders of two-thirds of the capital stock, to dispose of all corporate property except its franchises held to contravene statute restricting sale to a foreign corporation); *Kaplan v. Block*, 183 Va. 327, 31 S.E.2d 893 (1944) (charter clause providing that no act of the directors shall be valid unless approved by a unanimous vote of the directors held invalid, the court apparently believing it inconsistent with a number of statutory sections including one providing that every corporation shall be managed by a board of directors); *State ex rel. Badger Tel. Co. v. Rosenow*, 174 Wis. 9, 182 N.W. 324 (1921) (charter clause providing for election of officers by the shareholders is inconsistent with statute stating that they shall be chosen by the directors). The extent to which a court will sometimes go in finding a mandatory norm is pointed up by the following language from the opinion in *State ex rel. Ross v. Anderson*, 31 Ind. App. 34, 67 N.E. 207, 210 (1903): "The statute expressly requires that the certificate shall state the number and names of the directors to manage the affairs of the company for the first year. A statement of the names of the directors to manage the affairs of the company always is, of course, in plain disagreement with this statutory requirement."

The following cases declare statutory rules to be directory or so construe statutory language as to avoid conflict: *Union Trust Co. v. Carter*, 139 Fed. 717 (C.C.W.D. Va. 1905) (charter clause providing that shareholders would not vote or participate in the control of the corporation for a period of six years during which time the entire management and control would be vested in the directors was upheld notwithstanding statute providing for annual meetings of the shareholders); *Orme v. Salt River Valley Water Users' Ass'n*, 25 Ariz. 324, 217 Pac. 935 (1923); *Lehmaier v. Bedford*, 99 Conn. 468, 121 Atl. 810 (1923) (statute declaring that a majority of the directors shall constitute a quorum held "merely directory" and not to invalidate a charter provision classifying directors and providing that less than a majority would constitute a quorum); *Lippman v. Kehoe Stenograph Co.*, 11 Del. Ch. 190, 98 Atl. 943 (Ch. 1916), *rev'd* 11 Del. Ch. 412, 102 Atl. 988 (Sup. Ct. 1918) (charter provision permitting shareholders and directors to hold meetings outside of Delaware not in conflict with statute providing that meetings may be held outside of the state if the by-laws so provide); *Ripen v. Jacobs*, 205 N.Y. 442, 98 N.E. 855 (1912) (charter clause providing that the number of directors fixed in the charter should not be changed except by the unanimous consent of the shareholders was sustained against contention that it contravened statute which set up a method for increasing or reducing the number of directors; the court referred to the statute as being "merely permissive").

74. *Leviton v. North Jersey Holding Co.*, 106 N.J. Eq. 517, 520, 151 Atl. 389, 390 (ch. 1930).

75. *Clausen v. Leary*, 133 N.J. Eq. 324, 329, 166 Atl. 623, 625 (ch. 1933).

76. 195 App. Div. 518, 186 N.Y.S. 430 (1st dep't), *aff'd mem.*, 231 N.Y. 615, 132 N.E. 910 (1921). "Future shareholders, the persons who contribute the capital and are chiefly concerned, have no voice in drafting the articles which

vision requiring unanimous shareholder consent to elect directors would work a fraud on purchasers unaware of the provision.

The word "lawful" and other limiting language used in the broad statutes does not refer solely to statute law; the limitation is broader than that. Under the Delaware statute, authorizing charter clauses "not contrary to the law" of the state, the word "law" has been held to embrace some common law principles.⁷⁷ As a matter of fact, in some states the limiting language of these statutes has been seized upon to declare invalid charter provisions considered to be inherently forbidden by the nature of the structure and operation of a corporation or in some way contrary to public policy.⁷⁸ In condemning a charter provision, a court may declare that it is contrary to common law, public policy, and the statutes of the state, all three;⁷⁹ or it may state that it violates a common law rule "re-enforced as it is by statute" and also works a fraud upon the public.⁸⁰

Another approach the courts sometimes take is to read into a statutory rule certain common law concepts and then hold the rule thus broadened voids the charter provision. Thus, in *Audenried v. East Coast Milling Co.*,⁸¹ the court read into a statute providing that the business of every corporation shall be managed by its directors the common law principle that directors must act as a board and not separately, and struck down a charter provision that resolutions in writing signed by all members of the board constituted board action.

Yet the word "laws" and other language of similar import obviously does not include *all common law rules*.⁸² If all common law rules appli-

limit and define their rights. Most of them invest and become parties to the charter contract without reading the articles to ascertain provisions which may deprive shareholders of their customary rights and protection. Special and unusual provisions may thus prove traps for unwary investors and give opportunity for abuse and oppression by the management." *BALLENTINE, CORPORATIONS* § 16 (rev. ed. 1946).

77. *State ex rel. Cochran v. Penn-Beaver Oil Co.*, 143 Atl. 257 (Del. Ct. in Banc 1926); *Sterling v. Mayflower Hotel Corp.*, 89 A.2d 862 (Del. Ch.), *aff'd*, 93 A.2d 107 (Del. Sup. Ct. 1952).

78. *Page v. Anderson*, 31 Ind. App. 34, 67 N.E. 205 (1903); *Greene v. E. H. Rollins & Sons*, 22 Del. Ch. 394, 2 A.2d, 249 (Ch. 1938). Illustrative of the broad, vague attacks that are sometimes made of charter clauses are the following contentions advanced by plaintiff in *Lewis v. H. P. Hood & Sons*, 331 Mass. 670, 121 N.E.2d 850, 852 (1954): "[These] provisions which purport to give the directors power to call shares of the * * * corporation's common stock against the will of the holder at any time and for any or no reason exceed the limits of corporate power established by the governing statutes. They destroy the independence of stockholders in matters which the statutes commit to them; they place the stockholders as to all corporate matters at the mercy of directors; they violate the basic doctrine that all holders of the same class of shares be treated alike; indeed they are inherently discriminatory and by their nature invite abuse. They do, in fact, cut through all the basic attributes of common stock ownership." The court upheld the provisions.

79. See *Kaplan v. Block*, 183 Va. 327, 31 S.E.2d 893 (1944).

80. *In re Boulevard Theatre & Realty Co.*, 195 App. Div. 518, 186 N.Y. Supp. 430 (1st Dep't), *aff'd mem.*, 231 N.Y. 615, 132 N.E. 910 (1921).

81. 68 N.J. Eq. 450, 59 Atl. 577 (Ch. 1904).

82. See *Sterling v. Mayflower Hotel Corp.*, 93 A.2d 107 (Del. Sup. Ct. 1952), *affirming*, 89 A.2d 862 (Del. Ch. 1952).

cable to corporations were to be held absolutely impregnable to charter modification, there would be little if any room left for the operation of the broad grant of authority to use optional clauses. In general, the courts have recognized this and have sanctioned some charter departures from common law rules.

The courts have had a great deal of difficulty deciding what common law rules can be departed from in the charter and the extent of departure which will be permitted. Thus, in *State ex rel. Cochran v. Penn-Beaver Oil Co.*,⁸³ although the court held that statutory authority to use provisions in the charter "to create, define, limit and regulate" powers of the shareholders did not sanction charter provisions absolutely depriving shareholders of their common law right to inspect corporate books and records,⁸⁴ it indicated that this holding did not mean that the charter could not limit the common law right and require it to be exercised at proper times, under proper conditions, for proper purposes, and so as not unreasonably to interfere with the company's business.⁸⁵ The court drew a distinction between the destruction of a common law right and its regulation,⁸⁶ and indicated that the statute did give authority to limit and regulate by reasonable charter provision the common law rights and privileges of the shareholder.

The courts appear to look into how firmly fixed a common law rule is, how strong the policy considerations are which gave rise to it, and the business need supposedly justifying a departure from it. The verbal formula worked out by the Delaware courts is that a charter clause cannot achieve a result "forbidden by settled rules of public policy" or "transgress a statutory enactment or a public policy settled by the common law or implicit in the General Corporation Law itself."⁸⁷ Thus, in that state, if there is a split of authority at common law on a rule regulating the internal affairs of a corporation, the incorporators may adopt the rule sanctioned by the minority common

83. 143 Atl. 257 (Del. 1926).

84. "A common law right can be taken away only by a statute that expressly by necessary implication authorizes it." *State ex rel. Cochran v. Penn-Beaver Oil Co.*, 143 Atl. 257, 259 (Del. Ct. in Banc 1926). Can a shareholder by simple contract give up his privilege of inspection? See *Greene v. E. H. Rollins & Sons*, 22 Del. Ch. 394, 2 A.2d 249, 252 (Ch. 1938) ("No individual may exercise his broad power to enter into contract relations so as to offend against what the law deems to be sound public policy.").

85. Similarly, the courts have held that although reasonable restrictions on the shareholders' privilege of inspection may be imposed in the by-laws, by-laws purporting to give the directors absolute power to refuse inspection are invalid. *Klotz v. Pan-American Match Co.*, 221 Mass. 38, 108 N.E. 764 (1915); *Commonwealth ex rel. Wilde v. Pennsylvania Silk Co.*, 267 Pa. 331, 110 Atl. 157 (1920).

86. See discussion of the *Penn-Beaver* case in *Sterling v. Mayflower Hotel Corp.*, 93 A.2d 107, 117-18 (Del. Sup. Ct. 1952).

87. *Sterling v. Mayflower Hotel Corp.*, *supra* note 86, at 118.

law view.⁸⁸ In *Sterling v. Mayflower Hotel Corporation*⁸⁹ the court held the rule (accepted as common law by Delaware but not by all jurisdictions) which precludes the counting of interested directors for quorum purposes does not invalidate a charter provision which sanctions their being counted, at least in situations where the action taken at the directors' meeting is submitted to and approved by the shareholders.⁹⁰ Similarly, a Delaware court has sustained a charter provision authorizing sale of all corporate assets on the consent of holders of three-fourths of the stock, against the objection that the provision was not authorized by statute and was contrary to the common law.⁹¹

A Virginia court has sustained a charter clause authorizing a corporation to enter into partnership arrangements, commenting that there is not "any essential illegality" in a corporation's forming a partnership and that the charter provision did not authorize "anything which is *malum in se*."⁹² Even when upholding charter provisions modifying common law rules, courts have cautioned that they will not sanction the abusive or inequitable use of such charter provisions.⁹³

Though courts sometimes profess not to be concerned with the business wisdom of a challenged charter provision,⁹⁴ the remarks judges make in their opinions indicate that in truth courts are greatly influenced by the judges' views on whether the charter provision is

88. *Piccard v. Sperry*, 48 F. Supp. 465, 469 (S.D.N.Y. 1943), *aff'd mem.*, 152 F.2d 462 (2d Cir.), *cert. denied*, 328 U.S. 845 (1946).

89. 93 A.2d 107, 118 (Del. Sup. Ct. 1952).

90. *Accord*, *Kaufman v. Schoenberg*, 91 A.2d 786 (Del. Ch. 1952) (approval of stock option plan by interested directors with later stockholder ratification). See also *Martin Foundation v. North American Rayon Corp.*, 68 A.2d 313 (Del. Ch. 1949) (sustaining a charter clause which the court interpreted as defining the disqualifying interest of directors more broadly than under Delaware common law).

91. *Butler v. New Keystone Copper Co.*, 10 Del. Ch. 371, 93 Atl. 380 (Ch. 1915).

92. *News-Register Co. v. Rockingham Pub. Co.*, 118 Va. 140, 86 S.E. 874, 876-77 (1915).

93. "But it must be kept in mind that even a valid provision cannot be exercised oppressively or for the purpose of discriminating against a single stockholder or group of stockholders. . . . Hence the exercise of the power where involved for purposes of reprisal, spite, or other motives tending to show bad faith would be an abuse of the power and would not stand." *Lewis v. H. P. Hood & Sons*, 331 Mass. 670, 121 N.E.2d 850, 853 (1954). A provision that in the absence of actual fraud, contracts or acts of a majority of the directors shall not be invalid or voidable because some or all of the directors are interested, and that no director shall be incapacitated from voting because of his interest is without force as contrary to public policy if construed as validating a transfer of all the common stock to promoters for an option worth much less than the par value of the stock. *Whalen v. Hudson Hotel Co.*, 183 App. Div. 316, 170 N.Y. Supp. 855 (3d Dep't 1918). Note that in *Piccard v. Sperry Corp.*, 48 F. Supp. 465 (D.C.N.Y. 1943), which upheld a charter provision permitting an interested director to be counted towards a quorum, there was a finding that the action taken by the directors was attended by good faith, sound business judgment and prudent solicitude for the welfare of the corporation.

94. *Martin Foundation v. North American Rayon Corp.*, 68 A.2d 313, 316 (Del. Ch. 1949).

designed to meet a legitimate business need and will contribute to the efficient operation of the business.⁹⁵ Sometimes the courts in talking about public policy really seemed to be concerned about business policy. Some courts, for instance, have been reluctant to uphold charter provisions setting up high vote requirements for shareholder and director action, because they believe provisions of this type are likely to cause corporate paralysis.⁹⁶ The lawyer, in planning and drafting charter provisions, should keep in mind this tendency of the courts to be swayed by their estimation of the wisdom and efficacy of the provisions under consideration.

C. Jurisdictions Without Statutes Authorizing Optional Charter Clauses.

In a number of states, there appears to be no statutory authorization for the use of optional charter provisions.⁹⁷ The corporation act in those states simply enumerates the items that must be included in the charter. Nowhere in the act are optional charter provisions mentioned or statements made indicating the legislature contemplated use of such provisions.

In spite of this absence of statutory authorization, some lawyers in those jurisdictions do on occasion insert optional clauses in charters they prepare. Whether those clauses will be given effect if challenged is doubtful. Charter clauses not supported by authorization in the corporation act have met with a varied judicial reception. Many decisions, particularly the earlier ones, held that matters in the charter not responsive to some specification in the corporation law were void and would be given no force or effect.⁹⁸ Other decisions gave effect

95. "This is in effect to say that such a provision may well fill a legitimate need in the efficient functioning of the corporate enterprise. We agree; and we see no basis for declaring it unlawful." *Sterling v. Mayflower Hotel Corp.*, 93 A.2d 107, 119 (Del. Sup. Ct. 1952). In *Greene v. E. H. Rollins & Sons*, 22 Del. Ch. 394, 2 A.2d 249 (Ch. 1938), holding invalid a charter provision which required a shareholder to sell his stock to the corporation on request by the directors, the court relied in part on the fact that it did not appear that the restraint was reasonably necessary to advance the corporation's welfare and promote business success.

96. *Aldridge v. Franco Wyoming Oil Co.*, 24 Del. Ch. 126, 7 A.2d 753 (Ch. 1939), *aff'd*, 24 Del. Ch. 349, 14 A.2d 380 (Sup. Ct. 1940); *Kaplan v. Block*, 183 Va. 327, 31 S.E.2d 893 (1944). "Right after right is violated. No suit can be brought without a dissenter's consent, nor can two-thirds of outstanding stockholders elect to go out of business. Instances might be multiplied." *Kaplan v. Block*, *supra*, 31 S.E.2d at 897.

97. See ARIZ. CODE ANN. § 53-301 (1939); IOWA CODE § 491.5 (1954); ME. REV. STAT. ANN. c. 53, § 10 (1954); MISS. CODE ANN. § 5310 (Supp. 1952); OKLA. STAT. tit. 18, § 15 (1951); S.C. CODE §§ 12-58 (1952); WYO. COMP. STAT. ANN. § 44-101 (1945). The old Texas Corporation Act, recently replaced by new legislation based on the Model Corporation Act, made no reference to optional provisions. See TEX. BUS. CORP. ACT art. 3.02 (1955).

98. *Oregon Ry. & Nav. Co. v. Oregonian Ry.*, 130 U.S. 1 (1888); *Grangers' Life & Health Ins. Co. v. Kamper*, 73 Ala. 325 (1882); *Ross v. Anderson*, 31 Ind. App. 34, 67 N.E. 207 (1903); *Eastern Plankroad Co. v. Vaughan*, 14 N.Y. 546 (1856). The reason sometimes given for these holdings is that the specific enumeration by the statute of the contents of the charter necessarily implies

to unauthorized charter clauses as by-laws⁹⁹ or as agreements binding on persons becoming shareholders with notice of them,¹⁰⁰ but refused to consider them part of the charter. On the other hand, a number of decisions, even some of the earlier ones, have treated such clauses as part of the charter as long as they are not prohibited by statute and are not contrary to public policy.¹⁰¹ In some instances, charter clauses have been given effect even against persons dealing with the corporation or its stock without regard to whether those persons actually knew the clauses existed.¹⁰²

D. Effect of Changing Conception of Nature of Corporation on Validity of Optional Charter Clauses.

A gradual but fundamental change in the way judges and lawyers think about corporations and the relations created between the state and businessmen by incorporation is being reflected in judicial decisions passing on the validity of optional charter provisions. A court's conception of the nature of the corporation and of the function that a corporate charter serves is an important key to whether that court will sustain a charter clause which has shaky statutory support or which is challenged as violative of a statutory norm or as contrary to public policy.

The traditional theory of course was that a corporation is an artificial, fictitious entity and that a corporate charter is a grant from the sovereign which gives "life" to a new legal unit. This view is known as the "concession theory." The grant or concession from the sovereign had to be accepted *in toto* by the participants or not at all.

The traditional theory is in part accounted for by the early history of corporate development in this country. Incorporation in those early years was by special legislative act; and charters were granted sparingly and usually contained many limitations and safeguards. Legislators and courts feared that a free and unrestricted use of the corporate device would lead to encroachments upon the liberties and

the exclusion of other items. *California Tel. & Light Co. v. Jordan*, 19 Cal. App. 536, 126 Pac. 598 (1912). The unauthorized provisions have generally been treated as surplusage and have not had the effect of invalidating the whole charter. *McIlvaine v. Foreman*, 292 Ill. 224, 126 N.E. 749 (1920); *Eastern Plankroad Co. v. Vaughan*, 14 N.Y. 546 (1856); *Anderson-Dulin-Varnell Co. v. Williams*, 148 Tenn. 388, 255 S.W. 597 (1923). See also 1 FLETCHER, PRIVATE CORPORATIONS § 150 (perm. ed. rev. repl. 1931).

99. *Shaw v. Bankers' Nat'l Life Ins. Co.*, 61 Ind. App. 346, 112 N.E. 16 (1916); *Sherman Center Town Co. v. Morris*, 43 Kan. 282, 23 Pac. 569 (1890).

100. See *Wright v. Iredell Tel. Co.*, 182 N.C. 308, 108 S.E. 744, 746 (1921).

101. *Estes v. Bank*, 172 Miss. 499, 159 So. 104 (1935); *Gibbs v. Long Island Bank*, 83 Hun 92, 31 N.Y. Supp. 406 (Sup. Ct., Gen. T. 1894). For decisions in which courts seemed to assume that charter clauses were valid although the clauses had no statutory support, see *Mack v. De Bardelaben C. & I. Co.*, 90 Ala. 396, 8 So. 150 (1890); *Conant v. Millaudon*, 5 La. Ann. 542, 544 (1850).

102. *Dempster Mfg. Co. v. Downs*, 126 Iowa 80, 101 N.W. 735 (1904).

opportunities of the individual.¹⁰³ A legislatively granted charter usually fixed the corporation's financial and managerial structure; no important arrangements were left to the determination of the participants. Courts looked upon departures from the approved corporate pattern as violative of legislative intent. Perhaps the reluctance of the courts to permit deviation from the normal corporate pattern was reinforced by a desire to maintain uniformity of corporate functions and privileges, and a fear of reckless business arrangements that might lead to bankruptcies, corporate paralysis, or other results harmful to creditors, minority shareholders or the public.

Since the advent of incorporation under general corporation laws, and the disappearance of incorporation by special legislative act, the traditional theory that a corporation is an artificial being created by sovereign grant has been slowly giving way to the conception of a corporation as a group of individuals voluntarily associating together to conduct a business enterprise.¹⁰⁴ Modern incorporation statutes give the incorporators broad freedom to fix the financial and managerial structure of the corporation and to lay down rules to govern corporate affairs.

A corporate charter is now often thought of as an agreement among the participants—a contract regulating the enterprise, its management, and the various rights and duties of the participants. This contract, it is true, must be drawn within the framework of the corporation act; but the sovereign is not thought of as really playing an active and major role in shaping the agreement.

The modern conception of the corporate charter as primarily a contract among participants in an enterprise is conducive in at least three respects to an increased judicial readiness to sustain optional charter provisions. First, courts are somewhat more likely to give a broad inclusive scope to general statutory provisions authorizing the use of optional charter clauses. Second, courts are less likely to look upon rules set forth in the corporation statute as inflexible norms or statements of policy that cannot be deviated from by charter provision.¹⁰⁵

103. See Mr. Justice Brandeis, dissenting in part, in *Louis K. Liggett Co. v. Lee*, 288 U.S. 517, 541 (1933).

104. See Dodd, *Amendment of Corporate Articles Under the New Ohio General Corporation Act*, 4 U. CIN. L. REV. 129, 130 (1930).

105. As early as 1912, the New York Court of Appeals recognized that at least some statutory norms (which were not expressly stated as subject to change by charter provision) could be modified by the insertion of provisions in the certificate of incorporation. The Court commented that "lawmakers, while prescribing general rules in default of agreement to the contrary, permitted the incorporators, by agreement made at the inception of the corporation and embodied in the certificate by which the corporation got life, to regulate these unessential matters in such manner as they might agree." *Ripm v. United States Woven Label Co.*, 205 N.Y. 442, 98 N.E. 855, 856 (1912). But see *Benintendi v. Kenton Hotel*, 294 N.Y. 112, 60 N.E.2d 829 (1945) (holding invalid by-laws requiring unanimity for shareholder or director action, but on grounds broad enough to invalidate such provisions in the charter).

Courts that consider a charter as a private agreement among businessmen can quite naturally conclude that norms in the corporation act reflect public policy only to the extent that adherence to them is necessary to protect the interests of persons not parties to the agreement. Third, courts in jurisdictions which do not have statutes authorizing optional charter provisions are more likely to permit the incorporators to use such provisions on the ground that parties to the charter contract (like parties to other agreements) should be privileged to use whatever clauses they see fit as long as the clauses are not prohibited by law or contrary to public policy.

E. Administrative Control of Optional Clauses.

Before filing a charter containing unusual clauses the lawyer should check to determine whether administrative controls limit the type of provision that may be included in the charter. In most states, the charter must be filed with and approved by a Commissioner of Corporations, the Secretary of State or some public official. The official is usually given power to examine the charter, pass on whether its provisions are consistent with law and public policy, and reject charters that do not comply.¹⁰⁶ The Iowa statute, for example, gives the Secretary of State substantial power to reject charter provisions which are not in proper form, which express an unlawful object or are against public policy, or which show that the corporate plan for doing business is dishonest or unlawful.¹⁰⁷ The Secretary of State appears to have assumed that this statute empowers him to pass on the propriety of optional clauses, and the Iowa courts have not seemed inclined to interfere with his judgment.¹⁰⁸

In some jurisdictions, examination and approval of charters by the Secretary of State is perfunctory. In an increasing number of states, however, the charter is given a really thorough examination before it is accepted, and the examining official is inclined to veto extreme experiments.

The authorities are uniform that although the Secretary of State or other public official can be compelled by a mandamus to file a charter containing a provision authorized by law,¹⁰⁹ he cannot be required to file a charter containing a provision that is illegal or unauthorized.¹¹⁰

106. See *Westlake Park Inv. Co. v. Jordan*, 198 Cal. 608, 246 Pac. 807 (1926).

107. IOWA CODE § 491.6 (1954).

108. See *Mason v. Mallard Tel. Co.* 213 Iowa 1076, 240 N.W. 671 (1932).

109. *People ex rel. Browne v. Keonig*, 133 App. Div. 756, 118 N.Y. Supp. 136 (1st Dep't 1909).

110. *People ex rel. Hardin v. Emmerson*, 315 Ill. 241, 146 N.E. 129 (1925); *People ex rel. Barney v. Whalen*, 119 App. Div. 749, 104 N.Y. Supp. 555 (3d Dep't), *aff'd mem.*, 189 N.Y. 560, 82 N.E. 1131 (1907) (provision termed "plainly illegal"); *Sneed v. Tippet*, 114 Okla. 173, 245 Pac. 40 (1926). "On the other hand when the provision is reasonably susceptible with an interpretation which will conform to law it is the duty of the Secretary of State to approve the provision." Aspey, *Suggestions and Precautions in Drafting Articles*

To avoid loss of time and the embarrassment that might result from the rejection of a charter, the lawyer should examine the agency's regulations, if there are any,¹¹¹ and he should consider informal submission of questionable provisions in advance of formal submission for filing. Consultation and the careful spelling out of unorthodox provisions might avoid a veto that would otherwise be forthcoming. A change of a few words will sometimes eliminate an objection.

The agency's approval of a doubtful provision may strengthen the chances of its being upheld when challenged in court. In other words, the odds that a particular provision will be upheld in litigation are somewhat greater after agency approval than they are in a mandamus proceeding to require the agency to accept the charter for filing. In an Iowa case,¹¹² in which the validity of a charter provision restricting the transferability of shares was in issue, one of the reasons most strongly relied on by the court in sustaining the provision was that the charter had been approved by the Secretary of State, who could have rejected it as containing material contrary to law or public policy.¹¹³ Further, questions of form, such as whether a particular provision should be inserted among the financial clauses or in a separate part of the charter containing optional provisions, appear to be entirely within the discretion of the public agency with which the charter is filed.¹¹⁴ If the public official does file the charter and a court later holds a clause to be improper, the fact that it contains unauthorized provisions will not render the creation of the corporation void, such unauthorized provisions at most being treated only as surplusage.¹¹⁵

OPTIONAL CLAUSES IN CURRENT USE; BUSINESS NEEDS CALLING FOR OPTIONAL CLAUSES

A wide variety of optional clauses have been used in the charters of American corporations. Some optional clauses are used so frequently that they are considered almost "boiler plate." Others are used in only a few localities or by only a few lawyers or firms.

of Incorporation, in ORGANIZING AND REVISING SMALL BUSINESS ENTERPRISES 162, 171 (Cal. Pract. Hand Book No. 2, 1954).

111. In some states, the agency has rather detailed regulations. The Commissioner of Corporations and Taxation in Massachusetts has in recent years generally refused to approve restraints on the transferability of stock other than those in a form that he himself prepared.

112. *Mason v. Mallard Tel. Co.*, 213 Iowa 1076, 240 N.W. 671 (1932).

113. See criticism of this argument in 18 Iowa L. Rev. 88 (1932).

114. *News-Register Co. v. Rockingham Pub. Co.*, 118 Va. 140, 86 S.E. 874, 878 (1915) ("... the matter was one which, certainly as to form if not as to substance, addressed itself to and was clearly within the jurisdiction of the Corporation Commission, and its action thereon is final"). DODD AND BAKER, CORPORATIONS 104 n.2 (2d ed. 1951), raise the query of "whether it is the duty of the public official to accept papers which comply substantially but not literally with the provisions of the statute."

115. See 1 FLETCHER, PRIVATE CORPORATIONS §150 (perm. ed. rev. repl. 1931).

The more popular clauses and the recurring business situations that call for optional provisions are discussed in the following pages under the subheadings "Management Clauses," "Clauses for Closely Held Corporations," and "Clauses That Might Strengthen Democratic Processes in Corporate Government." The clauses considered under those subheadings, however, do not really give a complete picture of the wide variation in optional clauses. That can only be shown by listing some of the less popular and more unusual clauses. Among the more unusual clauses are provisions which accomplish the following: authorize a charter amendment creating an issue of prior preferred stock with rights superior to existing preferred and effecting a cancellation of unpaid accumulated dividends;¹¹⁶ limit the right of a director (absolute and unqualified at common law) to examine corporate books and records; limit the operations of the corporation to a named business or kind of activity and provide specifically that no other business can be undertaken without the unanimous consent of the shareholders; grant power to the corporation to levy assessments upon the shares or upon any class of shares;¹¹⁷ decrease the vote otherwise required by statute for extraordinary corporation action such as consolidation, merger, sale of all corporate assets, dissolution or charter amendment; authorize employee stock purchase plans and perhaps set forth provisions for payment by installments and for repurchase of the shares by the corporation upon termination of employment;¹¹⁸ require that meetings of shareholders and directors be held in the state of incorporation or authorize those meetings to be held outside the state;¹¹⁹ prohibit the declaration of dividends as long as premiums on designated business insurance remain unpaid; permit shareholders to authorize a corporate recapitalization plan to become operative within the discretion of the directors;¹²⁰ declare insolvent persons ineligible for election as directors;¹²¹ grant a right to shareholders to change the corporate domicile;¹²² deny to shareholders a statutory right they would otherwise have to petition for dissolution.¹²³

116. See *Western Foundry Co. v. Wicker*, 403 Ill. 260, 85 N.E.2d 722, 727 (1949).

117. See CAL. CORP. CODE ANN. § 305(a) (Deering 1953).

118. See CAL. CORP. CODE ANN. §§ 1107, 1108 (Deering 1953). If the corporation is to be given the right to repurchase, on termination of employment, perhaps a separate class of shares should be created for issuance to employees. Otherwise the objection might be made that restrictions imposed on shares issued to employees are greater than on those issued to other holders.

119. *Russian Reinsurance Co. v. Stoddard*, 211 App. Div. 132, 207 N.Y. Supp. 574 (3d Dep't 1925). (Under N.Y. Stock Corp. Law § 5, if directors' meetings outside the state are not to be allowed, that limitation must be provided either in the certificate of incorporation or in the by-laws).

120. See *In re McKinney*, 306 N.Y. 207, 117 N.E.2d 256, 258 (1954).

121. See *Conant v. Millaudon*, 5 La. Ann. 542 (1850).

122. See *Estes v. Bank*, 172 Miss. 499, 159 So. 104 (1935).

123. See *Leventhal v. Atlantic Finance Corp.*, 316 Mass. 194, 55 N.E.2d 20, 154 A.L.R. 260 (1944) (holding the statutory right of a stockholder under specified conditions to petition for dissolution may be waived by contract).

In the following paragraphs, which consider the more commonly used optional clauses, several references are made to judicial decisions passing on the validity of particular clauses and to statutes which seem to support certain clauses. A word of caution is necessary. A particular statutory provision may take on a different meaning in the setting of another statutory scheme. A judicial decision in one jurisdiction sustaining a charter clause may be entitled to little or no weight by a court in another jurisdiction with different statutes. The authorities mentioned in the following pages therefore must be considered against the background furnished by the materials in the first part of this paper on the "Statutory and Case Law Bases for Optional Provisions."¹²⁴

A. Management Provisions.

Perhaps best known of the optional provisions are a group of clauses designed to increase the powers and freedom of action of directors and officers and to protect them against loss from acts taken in their official capacities.¹²⁵ These clauses are often referred to as "management provisions."

The charter of almost every large corporation contains a clause which provides¹²⁶ (1) that corporate transactions shall not be invalidated or affected by the fact that some of its officers, directors or shareholders are interested in another corporation that is a party to the transaction, (2) that interested directors shall be counted in determining whether a quorum exists at directors' meetings and may vote with the same effect as disinterested directors,¹²⁷ and (3) that interested directors are relieved from liability that might otherwise arise by reason of their contracting with the corporation for the benefit of themselves or any firm or corporation in which they are interested. The prevalence in the modern business world of transactions between corporations and their directors and of transactions

124. See pp. 1-23 *supra*.

125. For a set of specimen charter provisions "for the regulation of the internal affairs of the corporation," see PANTZER AND O'NEAL, *THE DRAFTING OF CORPORATE CHARTERS AND BY-LAWS* 81-84 (1951).

126. A less common provision but one directed toward the same problem states: "No contract or other transaction between the Corporation and one or more of its directors, officers or stockholders, or between the Corporation and any other corporation, firm or association, in which one or more of its directors, officers or stockholders are officers, directors or stockholders, shall be either void or voidable (1) if at a meeting of the Board of Directors or committee authorizing or ratifying the contract or transaction there is a quorum of persons not so interested in the contract or other transaction, and such contract or other transaction is approved by a majority of such quorum, or (2) if the contract or other transaction is ratified at an annual or special meeting of stockholders, or (3) if the contract or other transaction is just and reasonable to the Corporation at the time it is made, authorized or ratified."

127. Full disclosure of interest is often expressly made a condition of the application of parts (1) and (2) of the clause.

between corporations with interlocking directorates have made optional charter provisions of this sort necessary.

Just exactly what legal effect a clause of this kind has is doubtful. It will not relieve an officer or director from liability for actual fraud.¹²⁸ It might, however, change the standard of fairness or burden of proof that would otherwise prevail whenever a transaction between a corporation and interested directors or between corporations with interlocking directors is challenged.¹²⁹ Further, the statement that interested directors are to be counted in determining a quorum has been uniformly given effect, at least if the transaction later was approved by the shareholders.¹³⁰

Another common management clause is designed to indemnify corporate representatives for losses incurred while acting in corporate capacities. A clause of this type typically provides that the corporation will indemnify its directors, officers and other representatives for the reasonable expenses including attorneys' fees incurred in the defense of litigation to which they are made parties by reason of their relation to the corporation.¹³¹

128. See *Whalen v. Hudson Hotel Co.*, 183 App. Div. 316, 170 N.Y. Supp. 855 (3d Dep't 1918).

129. See *Dodd and Baker, Corporations* 478 n.2 (2d ed. 1951). "[The] provision of the certificate of incorporation of Empire Power Corporation expressly authorizing the directors to act even in matters where they had dual interest, has the effect of exonerating the directors, at least in part, 'from adverse inferences which might otherwise be drawn against them.'" *Everett v. Phillips*, 288 N.Y. 227, 43 N.E.2d 18, 22 (1942). "The finding as to 'bad faith' appears to rest largely upon the circumstance that the individual defendants were directors of the bank as well as of the defendant, and that one was also a director of the Beacon Trust Building Trust, Inc. But such interlocking directorates were expressly permitted by the corporate organization of the defendant. Of course, this gave no immunity to the defendant and directors to be guilty of bad faith. But it exonerates them from adverse inference which might otherwise be drawn against them." *Spiegel v. Beacon Participations*, 297 Mass. 398, 417, 8 N.E.2d 895, 907 (1937). "This provision is useful only to overcome any presumption of fraud or invalidity which might attach." *Israels and Gorman, Corporate Practice* 107 (1954). See also *Ewen v. Peoria & E. Ry.*, 78 F. Supp. 312, 317 (S.D.N.Y. 1948); 52 *MICH. L. REV.* 295 (1953).

130. *Piccard v. Sperry*, 48 F. Supp. 465 (S.D.N.Y. 1943), *aff'd mem.*, 152 F.2d 462 (2d Cir.), *cert. denied*, 328 U.S. 845 (1946); *Sterling v. Mayflower Hotel Corp.*, 93 A.2d 107 (Del. Sup. Ct. 1952); *Kaufman v. Schoenberg*, 91 A.2d 786 (Del. Ch. 1952).

131. A typical clause provides: "The Corporation shall indemnify any and all of its directors or officers or former directors or former officers or any person who may have served at its request as a director or officer of another corporation in which it owns shares of capital stock or of which it is a creditor against expenses incurred by them in connection with the defense or settlement of any action, suit or proceeding brought or threatened in which they, or any of them, are or might be made parties, or a party, by reason of being or having been directors or officers or a director or officer of the Corporation, or of such other corporation, except in relation to matters as to which any such director or officer or former director or officer or person shall be adjudged in such action, suit or proceeding to be liable for negligence or misconduct in the performance of duty. Such indemnification shall not be deemed exclusive of any other rights to which those indemnified may be entitled, under any by-law, agreement, vote of stockholders, or otherwise." For a comprehensive discussion of indemnity clauses, see *WASHINGTON, CORPO-*

Statutes in a number of states expressly authorize the use of indemnification provisions in the charter. The statutes differ considerably, however, on the extent of the indemnification that can be provided.¹³² Most of them permit indemnification only of corporate representatives who are free from negligence or misconduct. The New York statute, for instance, expressly excepts from the permissible coverage expenses incurred "in relation to matters as to which it shall be adjudged . . . that such officer, director or employee is liable for negligence or misconduct in the performance of his duties."¹³³ Further, the New York statute has been construed not to permit reimbursement if a settlement is made without court approval.¹³⁴

Some statutes give corporate representatives a right to recover litigation expenses, without regard to whether the corporation's charter contains an indemnification clause.¹³⁵ A statute of this kind or judicial recognition of a common law right of indemnification does not necessarily eliminate the need for a charter clause. The statutory or common law right may not be sufficiently inclusive to give desired protection or it may leave doubtful the coverage of some losses. The New York statutory right of indemnification, for instance, does not reimburse expenses incurred in defending against prosecutions under the Sherman Antitrust Act or in other criminal proceedings.¹³⁶ Perhaps indemnification for expense incurred in criminal proceedings cannot be provided in New York even by express charter provision;¹³⁷ in some states, however, the law seems elastic enough to permit indemnification clauses that include expenses of criminal litigation.¹³⁸

RATE EXECUTIVES' COMPENSATION c. 19 (1942). Even in the absence of statute or charter clause, some courts recognize a right in directors or officers to reimbursement for expenses incurred in defending themselves against a shareholders' action. See *In re E. C. Warner Co.*, 232 Minn. 207, 45 N.W.2d 388 (1950); *Solimine v. Hollander*, 129 N.J. Eq. 264, 19 A.2d 344 (Ch. 1941) (the court in which a shareholders' suit is brought can decree reimbursement). *But see* *Bailey v. Bush Terminal Co.*, 46 N.Y. Supp. 2d 877 (Sup. Ct. 1943), *aff'd mem.*, 267 App. Div. 899, 43 N.Y.2d 324 (1st Dep't 1944), *aff'd mem.*, 293 N.Y. 735, 56 N.E.2d 739 (1944) (directors who successfully defend actions brought against them charging misfeasance in office do not have common law right of reimbursement); *New York Dock Co. v. McCollom*, 173 Misc. 106, 16 N.Y.2d 844 (Sup. Ct. 1939).

132. See, e.g., ME. REV. STAT. ANN. c. 53, § 24 (1954); N.J. REV. STAT. § 14:3-14 (Supp. 1944); N.Y. GEN. CORP. LAW §§ 66-68. For discussions of indemnification statutes, see STEVENS, CORPORATIONS § 174 (2d ed. 1949); Comment, 52 MICH. L. REV. 1023, 1030-42 (1954).

133. N.Y. GEN. CORP. LAW §§ 66-68.

134. Letter from N.Y. Atty. Gen. to N.Y. Sec'y of State, Dec. 31, 1953.

135. See, e.g., N.Y. GEN. CORP. LAW § 64.

136. *Schwartz v. General Aniline & Film Corp.*, 305 N.Y. 395, 113 N.E.2d 533 (1953). Further, New York has held that statutory indemnification will be denied a director who engaged in wrong-doing even though he was never formally and literally adjudged liable for misconduct. *Diamond v. Diamond*, 307 N.Y. 263, 120 N.E.2d 819 (1954).

137. The Secretary of State of New York will not accept for filing certificates of incorporation which include provisions for indemnification of expenses incurred in criminal actions.

138. See, e.g., DEL. CODE ANN. tit. 8, § 122(10) (1953) (after specifying that

Further, a statutory right may not protect corporate representatives other than directors and officers, or may not protect corporate personnel serving at the corporation's request with subsidiaries. Finally, if a claim for reimbursement is based upon statute, a question may arise of whether the statutory right has extra-territorial effect.¹³⁹ The statutory right probably would be enforceable only in the courts of the state granting that right; and even in the courts of that state, a director or other corporate representative might not be able to recover litigation expenses incurred in suits brought against him in other jurisdictions. On the other hand, a charter provision can be drafted to cover expenses wherever incurred and a claim based thereon apparently would be enforceable in other jurisdictions as well as the state of incorporation.

At least one statute, however, makes the statutory remedy the exclusive method by which indemnification can be obtained and precludes the use of charter provision to vary the scope of indemnification.¹⁴⁰

Even if a state does not have a statute authorizing the use of indemnification provisions in the charter, it still may be wise to include such a provision in the charter. Undoubtedly the charter clause would not lessen the chance of recovery.

One word of caution is in order against excessive zeal in providing indemnification for corporate representatives. Draftsmen should be on the alert not to free directors and officers from proper liability for misconduct in office. Provisions to indemnify for amounts paid on judgments or in compromise settlements should be inserted only after careful consideration.¹⁴¹

corporations shall have power to indemnify directors and officers, the statute states: "Such indemnification shall not be deemed exclusive of any other rights to which those indemnified may be entitled, under any by-law, agreement, vote of stockholders, or otherwise." The Secretary of State of Delaware will accept charters containing a limited indemnification clause for expense in criminal actions, such as the following: "In the case of a criminal action, suit or proceeding, a conviction or judgment (whether based on a plea of guilty or *nolo contendere* or its equivalent, or after trial) shall not be deemed an adjudication that such director or officer is liable for negligence or misconduct in the performance of his duties, if such director or officer were acting in good faith in what he considered to be the best interests of the corporation and with no reasonable cause to believe that the action was illegal."

139. See STEVENS, CORPORATIONS § 174 (2d ed. 1949).

140. CAL. CORP. CODE ANN. § 830(e) (Deering 1953). See also Ballantine, *California's 1943 Statute as to Directors' Litigation Expenses*, 31 CALIF. L. REV. 515 (1943).

141. A statement that is sometimes included in the indemnification provisions is as follows: "The corporation may also reimburse to any director, officer or employee the reasonable costs of settlement of any action, suit or proceeding, if it shall be found by a majority of a committee composed of the directors not involved in the matter in controversy (whether or not a quorum) that it was to be the interests of the corporation that the settlement be made and that the director, officer or employee was not guilty of negligence or misconduct."

Another popular management provision protects directors who rely in good faith on the books and records of the corporation. Typical wording for a clause of this kind is as follows:

A director shall not be liable for dividends illegally declared, distributions illegally made to shareholders, or any other action taken in reliance in good faith upon financial statements of the corporation represented to him to be correct by the president of the corporation or the officer of the corporation having charge of its books of account, or certified by an independent public or certified accountant to fairly reflect the financial condition of the corporation; nor shall he be liable if in good faith in determining the amount available for dividends or distributions he considers the assets to be of their book value.

A recurrent problem of directors is to find a way to fix their own compensation. To meet this problem, a charter clause is often used which expressly authorizes the board of directors to make provision for compensating its members for their services as directors and clearly specifies that directors may serve the corporation in other capacities and receive compensation for those additional services.¹⁴² Sometimes the compensation of the directors is fixed in the charter itself as some specified percentage of net profits.¹⁴³

142. See *Adams v. Mid-West Chevrolet Corp.*, 198 Okla. 461, 179 P.2d 147, 175 A.L.R. 584 (1947) (by-law stating that a director might serve the corporation in some other capacity and receive "compensation therefor in any amount fixed by the board of directors with full membership present and acting" held to permit an interested director to vote to increase his salary as president).

143. The following provision (from the charter of an investment trust incorporated in New York) fixes the directors' compensation at a percentage of net profits:

"Unless and until otherwise provided by a by-law or by-laws duly adopted by the holders of a majority of the stock of the corporation at the time outstanding and entitled to vote the directors of the corporation, as such, shall be paid as compensation for their services as directors and for proportionate distribution among them, a sum equal to eight per cent (8%) of the net profits of the corporation each year. At the end of each year the amount of compensation to which the directors are so entitled shall be determined and set aside on the books of the corporation as owing to the directors. Payment of any such amounts so determined at the end of each year and as accumulated from year to year shall only be made under and subject to the following restrictions: The corporation shall not pay any portion of its net profits as compensation to the directors as such unless there is concurrently therewith distributed to the stockholders as dividends and amount of net profits or surplus of the corporation equal to at least twice the aggregate amount of such compensation to be paid to the directors; provided that upon any liquidation or dissolution of the corporation, whether voluntary or involuntary, the directors shall be entitled to receive the balance of any compensation so owed to them before any payment or other distribution is made to the stockholders of the corporation.

"The net profits of the corporation for the purposes of this provision for compensation to the directors shall be determined by a certified public accountant selected by the board of directors.

"The foregoing provision for compensation to the directors shall be additional to a fee of twenty dollars (\$20.00) to each director for attendance at meetings and reimbursements for expenses incurred through attendance at meetings and otherwise in and about the affairs of the corporation and to such sums, if any, as may be paid to any director for services rendered

Many charters contain a clause which authorizes the board of directors to determine whether and to what extent and at what times and places and under what conditions the books and accounts of the corporation will be open to inspection by the stockholders, and provides that a stockholder shall not have any right to inspect the books, accounts or documents of the corporation except as conferred by law or authorized by resolution of the directors or of the shareholders.¹⁴⁴ In the leading case of *State ex rel. Cochran v. Penn-Beaver Oil Co.*,¹⁴⁵ the court refused to give effect to a provision of this kind. The court there held that a statute permitting the inclusion in the charter of provisions "creating, defining, limiting and regulating" powers of shareholders does not authorize a clause empowering the directors to abolish entirely the shareholders' privilege of inspection or a clause making the exercise of the privilege dependent solely on the arbitrary discretion of the directors.

Exactly what limitations can be placed on shareholders' privileges to examine corporate books and records is not entirely clear. The statutes in most jurisdictions do not spell out with any particularity what inspection privileges the shareholders have,¹⁴⁶ and seem to permit modification of those privileges in the charter or by-laws. The court in the *Penn-Beaver* case indicated that reasonable restrictions can be placed on those privileges, that a charter clause can validly provide that inspection privileges must be exercised "at proper times, under proper conditions, for a proper purpose and so as not to interfere with the company's business."¹⁴⁷

The task of drafting a charter provision to define specifically the inspection rights of shareholders is a challenging one. The draftsman must determine what restrictions may be placed on the time and place of inspection, on the percentage or number of shares that may demand an inspection and on the purpose for which an inspection

to the corporation otherwise than in the capacity of director.

"The directors entitled to the payment herein provided for shall be those who shall have served as directors during the whole or any part of any year in which were earned any profits which are to serve as a basis for the determination of such compensation to the directors. In the event that any director shall have failed to serve as such during the whole of any year he shall be entitled to receive for each full calendar month of service as director, only one-twelfth of what he would have received had he been a director during the full year.

"The term 'year' as used herein shall be the calendar year."

144. See Koenigsberg, *Provisions in Corporate Charters and By-Laws Governing the Inspection of Books by Stockholders*, 30 GEO. L.J. 227 (1942). In the absence of statute and charter or by-law provision, shareholders are privileged to inspect corporate books and records at reasonable times and for proper purposes.

145. 143 Atl. 257 (Del. 1926).

146. For a discussion of some of the statutes see Koenigsberg, *supra* note 144, at 242. At least one statute, however, sets forth the shareholders' inspection rights in detail and provides that those rights cannot be limited in the charter or by-laws. CAL. CORP. CODE ANN. § 3003 (Deering 1953).

147. 143 Atl. 257, 260 (Del. 1926).

may be made. He will also need to consider the possibility of drafting separate inspection regulations for different types of books and records.

A clause regulating inspection rights should specify with particularity exactly what contracts, business documents and other records are subject to inspection. The clause might include a statement that shareholders shall not have the right to examine or receive information on "patents, inventions, apparatus, equipment, designs, blueprints, formulae, processes or other similar rights or property of the corporation or in respect to which the corporation may have any license or right."

The draftsman should also consider ways of preventing information obtained by an inspecting shareholder from being used to the detriment of the corporation. Perhaps he can set up as a condition of the inspection privilege an undertaking by the shareholder to indemnify the corporation for losses suffered from improper disclosure of information obtained in the course of the inspection. Further, it may be advisable to provide that a shareholder cannot delegate his right of inspection to a certified public accountant unless the shareholder and the accountant agree to furnish the corporation promptly a copy of each report made by the accountant.

Many charters contain a clause denying or limiting the shareholders' preemptive rights or the preemptive rights of one or more classes of shares. In most jurisdictions, there is considerable uncertainty in the absence of a charter provision as to the scope of shareholders' preemptive rights. Further, in a corporation with a complex stock structure, elimination of preemptive rights may be desirable to avoid the difficult task of apportioning new share issues among the various classes of shareholders. Most jurisdictions have statutes which expressly permit charter denial or restriction of preemptive rights,¹⁴⁸ and even in the absence of statute most courts would probably give effect to charter provisions accomplishing that result.¹⁴⁹

Even though shareholders are to retain their common law or statutory preemptive rights, a charter provision is desirable to require the shareholders to exercise their options and pay for the shares within a specified time after notice. If shareholders in a corporation with several classes of stock are to have preemptive rights, special care must be used in spelling out the rights of each class.

There are many other clauses which can be used to increase the

148. See, e.g., MICH. COMP. LAWS § 450.31 (Mason Supp. 1952).

149. See *Ohio Ins. Co. v. Nunnemacher*, 15 Ind. 294 (1860) (pre-emptive rights completely eliminated); *Real Estate Trust Co. v. Bird*, 90 Md. 229, 44 Atl. 1048 (1899) (pre-emptive rights can be qualified or regulated by charter). "It may be pointed out in this connection that the common-law rule granting the stockholder a pre-emptive right is not a strict rule of law, based upon public policy, but is a rule of intention resting upon a fair implication from the contract between the stockholder and the corporation." BRUNE, MARYLAND CORPORATION LAW AND PRACTICE § 97 (rev. ed. 1953).

power of the directors or free them from burdensome restrictions that interfere with the quick and efficient operation of the business.¹⁵⁰ Among these are provisions to accomplish the following: permit directors' and shareholders' meetings to be held outside the state of incorporation at places from time to time designated in the by-laws or by resolution of the board of directors;¹⁵¹ authorize the establishment of corporate offices and the keeping of corporate books outside the state of incorporation; give the directors power to adopt and amend by-laws without the assent of the shareholders; authorize the directors to determine the amount to be reserved as working capital and the amount to be set aside as contingency funds; empower the directors to fix or alter the various rights, powers and preferences of unissued stock; vest the entire control of the corporation in the directors for a specified period of time and deprive shareholders of all participation;¹⁵² give the directors power to fill vacancies that occur on the board; set quorum requirements or the vote necessary for shareholder or director action at a lower percentage of the shareholders or directors than would otherwise be required; give the directors power to fix the consideration for shares that are issued; empower the directors to sell all the corporation's property; and authorize the board of directors to make temporary and unsecured loans.

B. Clauses for Closely Held Corporations.

Optional charter provisions are particularly useful in molding the corporate device to the needs of closely held enterprises. Participants in a closely held enterprise usually consider themselves partners as to each other even if the enterprise is incorporated. They almost invariably want to be in a position to choose future associates and to bar the admission of persons affiliated with competitors and other outsiders who would not fit into their organization harmoniously. Thus, restrictions are commonly placed on the transferability of stock. Especially popular are clauses giving the corporation or the other shareholders a "first option" to purchase shares of a holder who decides to sell and sometimes of a holder who ceases to be an officer, director or employee of the corporation.

Reasonable stock transfer restrictions, at least the widely used

150. Some of these provisions are phrased in language of sweeping scope. Note the following specimen: "In addition to the powers and authorities hereinabove or by statute expressly conferred, the Board of Directors of the Corporation is hereby authorized to exercise all such powers and to do all such acts and things as may be exercised or done by a corporation organized and existing under the provisions of the Act."

151. See *Lippman v. Kehoe Stenograph Co.*, 11 Del. Ch. 190, 98 Atl. 943 (Ch. 1916); 11 Del. Ch. 412, 102 Atl. 988 (Sup. Ct. 1918), sustaining a clause of this sort.

152. See *Union Trust Co. v. Carter*, 139 Fed. 717 (C.C.W.D. Va. 1905), a questionable decision, sustaining a charter clause giving the directors complete control for six years.

"first option" provisions, are now sustained in almost all jurisdictions.¹⁵³

Clauses giving the shareholders or some of them power to veto corporate decisions are also frequently used in closely held enterprises. Participants in a closely held corporation commonly want powers (similar to those of partners in a firm) to veto corporate policies and decisions. This veto power can be given them by charter clauses requiring unanimity or a high vote for shareholder and director action or by clauses fixing high quorum requirements for meetings of shareholders and directors. Statutory or judicial support can be found in many jurisdictions for charter clauses which require unanimity or a high vote for shareholder or director action or fix high quorum requirements for shareholder and director meetings.¹⁵⁴

Both stock restrictions and veto provisions pose many difficult problems in planning and drafting, and the lawyer should give special study to precautions that will increase the serviceability of these provisions and protect them against circumvention or attack.¹⁵⁵

In working out arrangements to divide control among the several shareholders in a closely held corporation, the lawyer may want to include in the charter a provision for the election of directors by cumulative voting. By setting up cumulative voting, he may be able to insure to each shareholder a representative on the board of directors. Thus, cumulative voting coupled with a high vote requirement for director action can give each shareholder a veto over action within the province of the board of directors. As the classification of directors may have the effect of depriving a particular shareholder of the ability he would otherwise have to elect a representative to the board of directors, it may be wise to include in the articles a prohibition against the classification of directors.

There are many clauses besides veto provisions and provisions for cumulative voting that may be useful in setting up a control pattern

153. See Annot., 2 A.L.R.2d 745 (1948); Cary, *How Illinois Corporations May Enjoy Partnership Advantages*, 48 NW. U.L. REV. 427 (1953); Cataldo, *Stock Transfer Restrictions and the Closed Corporations*, 37 VA. L. REV. 229 (1951); O'Neal, *Restrictions on Transfer of Stock in Closely Held Corporations: Planning and Drafting*, 65 HARV. L. REV. 773, 777-84 (1952). A charter clause which was once in quite common use in both public held and closely held corporations gave the corporation a lien on a shareholder's stock to secure the payment of his indebtedness to the corporation. See *Dempster Mfg. Co. v. Downs*, 126 Iowa 80, 101 N.W. 735 (1904); *Gibbs v. Long Island Bank*, 83 Hun 92, 31 N.Y. Supp. 506 (Sup. Ct., Gen. T. 1894), *aff'd*, 151 N.Y. 657, 46 N.E. 1147 (1897); *Bohmer & Osterloh v. City Bank*, 77 Va. 445 (1883).

154. O'Neal, *Giving Shareholders Power to Veto Corporate Decisions: Use of Special Charter and By-Law Provisions*, 18 LAW & CONTEMP. PROB. 451, 457-64 (1953). Perhaps the best known of the statutes expressly authorizing the use of high vote and high quorum requirements in the charter is N.Y. STOCK CORP. LAW § 9.

155. See O'Neal, *Restrictions on Transfer of Stock in Closely Held Corporations: Planning and Drafting*, 65 HARV. L. REV. 773 (1952); O'Neal, *supra* note 154.

for a closely held corporation. Among these are clauses which provide that the number of directors fixed in the charter shall not be changed except with the unanimous consent of the shareholders;¹⁵⁶ permit the shareholders or a particular shareholder to remove directors at any time with or without cause;¹⁵⁷ grant to the shareholders, a particular class of shareholders, or named individual shareholders the power to select the officers or specified officers and fix their compensations;¹⁵⁸ provide that specified officers cannot be removed by the directors without cause or can be removed only by a unanimous vote of the directors;¹⁵⁹ provide that directors elected by designated shareholders or by a particular shareholder shall have exclusive power to select the officers or to select designated officers;¹⁶⁰ require a person to own a minimum number of shares to be eligible to serve as a director (this coupled with restrictions on the transferability of shares and on the issuance of additional shares may be used to "freeze" all shareholders on the board of directors);¹⁶¹ confer upon the shareholders powers ordinarily exercised by the directors (for instance, provide that the shareholders, not the directors, will make the by-laws);¹⁶² require shareholder approval for the sale or mortgage of corporate assets;¹⁶³ provide that voting at shareholders' meetings shall be by classes of shareholders in elections of directors and perhaps on other matters; provide that directors shall hold office for life or shall not be changed

156. See *Ripin v. United States Woven Label Co.*, 205 N.Y. 442, 98 N.E. 855 (1912); cf. *Christal v. Petry*, 275 App. Div. 550, 90 N.Y.S.2d 620 (1st Dep't 1949), *aff'd mem.*, 301 N.Y. 562, 93 N.E.2d 450 (1950).

157. For a discussion of validity of a by-law to this effect, see *Proceedings at the Annual Meeting of the Section of Corporation, Banking and Business Law (Chicago, August 16-17, 1954)*, 10 BUSINESS LAW., Nov. 1954, p. 9, 10-12. See also *Petition of Singer*, 189 Misc. 150, 70 N.Y.S.2d 550 (Sup. Ct. 1947); BALLANTINE, CORPORATIONS § 163 (2d ed. 1949). If directors are elected by cumulative voting, a clause giving shareholders power to remove part of the directors is inappropriate.

158. See Del. CODE ANN. tit. 8, § 142 (1953), indicating that by a provision in the by-laws the shareholders can be given power to elect officers.

159. See *Petition of Buckley*, 50 N.Y.S.2d 54 (Sup. Ct. 1944), sustaining by-law that prohibited directors from removing chairman of the board without cause.

160. See LA. REV. STAT. § 12:34 (1950).

161. "Especially where the number of individual stockholders is few, as in the typical Iowa corporation, representation on the board is very important. Devices can be built into the articles that may insure that representation. One method is to provide that all shareholders are to be directors. * * * Another method is to require that directors be shareholders, in which case the permissible number of directors often is equal to the number of shareholders outstanding." Hayes, *Stockholders' Rights in the Iowa Corporation* (Part IV of a Study of Iowa Incorporation Practices), 40 IOWA L. REV. 459, 469 (1955).

162. Many corporation statutes provide in some manner for the making of by-laws by the directors as well as the shareholders. Some statutes provide that the power to make by-laws shall be in the directors unless it is reserved to the shareholders by the charter.

163. See *Mannhardt v. Illinois Staats Zeitung Co.*, 90 Ill. App. 315 (1900); *Liverpool & London & Globe Ins. Co. v. Aleman Planting & Mfg. Co.*, 166 La. 457, 117 So. 554 (1928); *Bishop v. Kent & Stanley*, 20 R.I. 680, 41 Atl. 255 (1898).

except by unanimous vote of the shareholders (courts in most jurisdictions probably would not sustain a clause to this effect);¹⁶⁴ limit the number or percentage of votes a shareholder may cast irrespective of the number of shares held; restrict the number of shares a person may hold or decrease the voting power of shares acquired by a holder in excess of a specified number;¹⁶⁵ classify the board of directors and provide for election of part by one group of shareholders and part by another group.¹⁶⁶

In many closely held enterprises, there is really no need for a board of directors.¹⁶⁷ Shareholders should be permitted to run the corpora-

164. See Note, 28 COLUM. L. REV. 366, 368 (1928). "It is easy to see objections to such a provision as that directors shall be displaced only by the unanimous consent of the stockholders where there are thirty thousand of the latter, but does the objection hold where there are three?" Weiner, *Legislative Recognition of the Close Corporation*, 27 MICH. L. REV. 273, 277 (1929).

165. See KAN. GEN. STAT. ANN. § 17-2803(E) (1949). See also Mack v. Debardeleben Coal Co., 90 Ala. 396, 20 So. 150 (1889) (charter clause sustained that provided that no shareholder should vote more than one-fourth of the stock); Bartlett v. Fourton, 115 La. 26, 38 So. 882 (1905) (charter clause that no individual should hold more than a specified number of shares upheld). If a statute states that each shareholder "shall have" one vote for each share, the courts usually hold invalid charter clauses or by-laws that attempt to restrict the accumulation of voting power. See *People v. Emmerson*, 302 Ill. 300, 134 N.E. 707 (1922); *State v. Day*, 189 Ind. 243, 123 N.E. 402 (1919). But see *British Murac Syndicate v. Alperston Co.*, 113 L.T.R. 373 (1915). N.Y. GEN. CORP. LAW § 23 provides: "Unless otherwise provided in the certificate of incorporation each stockholder shall have one vote per share."

166. See *Investment Associates v. Standard Power & Light Corp.*, 29 Del. Ch. 225, 48 A.2d 501 (Ch. 1946), *aff'd*, 51 A.2d 572 (Del. Sup. Ct. 1947). "The articles may provide that a particular class or classes of shares or securities . . . may elect all or a certain number or proportion of the directors." LA. REV. STAT. § 12:34 (1950). The articles of association of the hospital (a corporation without capital stock) before the court in *Lehmaier v. Bedford*, 99 Conn. 468, 121 Atl. 810 (1923), divided the directors into two classes, those elected for a stated term by the members and those who became life directors by payment of a specified sum of money, and provided *inter alia* that quorum should consist of "seven of the elected directors" and that the by-laws could not be changed unless the alteration was proposed in writing by at least twelve directors, of whom six had to be elected directors. For a discussion of whether staggered terms for directors violate constitutional or statutory mandates making cumulative voting mandatory, see *Wolfson v. Avery*, 6 Ill. 2d 78, 126 N.E.2d 701 (1955); *Humphreys v. Wmouss Co.*, 125 N.E.2d 204 (Ohio App. 1955); Comment, 7 MERCER L. REV. 227 (1955).

167. "The Board, however, is generally but a superfluous complication. On the one hand, five stockholders may well manage their own affairs. On the other, once they create a board, the stockholders are shackled."

"For example, the board may be well-constituted to prevent the majority stockholder from dominating it. But where it is intended that he be sole determiner of dividend policies, but not of other action, the board generally cannot be adapted to both purposes." Winer, *Proposing a New York "Close Corporation Law"*, 28 CORNELL L.Q. 313, 316-17 (1943). Note also the following remarks of William H. Neiman in *Proceedings at the Annual Meeting of the Section of Corporation, Banking and Business Law (Chicago, August 16-17, 1954)*, 10 BUSINESS LAW. Nov. 1954, p. 9, 36; "The theory that the corporation conducts its normal operations only through directors is based upon the unfounded assumption that there is a traditional division of corporate functions. However, some of today's so-called "norms" are the precise reverse of earlier practices. Shareholders in the eighteenth century voted directly on certain matters of corporate policy and appointed the executive officers. In England the shareholders are regarded as the source of the directors' power. As I have already mentioned, Iowa does not require a board of directors. I

tion through officers selected directly by them. However, the corporation statutes in most states (Iowa is an exception) seem to require a board; and even aside from statutory requirements, the idea that a board of directors is an essential item in a corporation is so firmly engrained in the thinking of the courts and of the officials with whom the charter must be filed, that an attempt to dispense with the board might run into serious difficulties. Charter provisions giving the shareholders or even designated officers many of the powers normally within the province of the directors perhaps offer more hope.¹⁶⁸ The draftsman might well consider the possibility of giving management powers (the power to elect officers and to declare dividends, for instance) to the shareholders. Even here, however, the draftsman runs into the principle—often enunciated by the courts—that the shareholders cannot create a “sterilized” board of directors.¹⁶⁹

Some of the possibilities for setting up a management structure for a closely held corporation through the combination of several optional clauses are suggested by a group of clauses commonly used by a Massachusetts law firm. One clause sets up two classes of stock with identical rights except that each class acts separately to elect designated directors. Other clauses require the Treasurer, and perhaps the Assistant Treasurer, to be a holder of a particular class of stock, say Class A, and the President, and perhaps the Vice President, to be a director elected by a particular class of stock, say Class B.¹⁷⁰ The reason for the difference in treatment between the Treasurer and the President is that Massachusetts law requires that the President must be elected by and from the Board of Directors, whereas the Treasurer is elected by the shareholders.¹⁷¹

In preparing a charter for a closely held corporation, a need may arise for a type of clause not customarily placed in charters. For instance, in setting up a procedure for surviving shareholders to purchase the shares of a deceased holder, the draftsman may want to include clauses to bind the corporation or the shareholders to purchase

think it is pointless to insist upon prerogatives when they have no utility. Often a board of directors has no real function in a closely held corporation.”

168. In *North-West Trans. Co. v. Beatty*, 12 App. Cas. 589 (P.C. 1887), the Privy Council quoted a by-law which provided: “. . . the powers conferred upon the directors by Section 22 were made subject to a proviso that one-fourth part in value of the shareholders of the company should at all times have the right to call a special meeting for the transaction of any business specified in such written requisition and notice as they might issue to that effect.” See also *Group Property, Inc. v. Bruce*, 248 P.2d 761 (Cal. App. 1952) (charter may designate individual manager of corporation with power to supervise and direct its business).

169. See *Manson v. Curtis*, 223 N.Y. 313, 119 N.E. 559, 562 (1918). For a discussion of shareholder contracts that limit the discretion of directors, see *STEVENS, CORPORATIONS* § 146 (2d ed. 1949).

170. Specimen clause: “The Treasurer and any Assistant Treasurer must be a holder of Class A stock. The President and any Vice President shall be elected by and from the Board of Directors, but must be Directors of Class B.”

171. *MASS. ANN. LAWS* c. 156, § 22 (1948).

business insurance that will provide readily available funds when the shareholder dies. A matter of this kind is customarily covered by a shareholders' agreement, but coverage in the charter may offer advantages.¹⁷² Similarly, the draftsman may find it convenient to "personalize" some of the clauses and refer to particular shareholders by name. Little can be said on the validity of unorthodox provisions of these types. Perhaps they would be sustained under the broadly worded statutes authorizing optional provisions.¹⁷³ In *Larsen v. The Lilly Estate*,¹⁷⁴ the court without citing any statutory authority upheld a charter provision reading as follows:

Should Charles H. Lilly, Jr. and/or Gordon Lilly, at the time they respectively arrive at the age of twenty-one years, own any of the preferred stock, the preferred stock which the one arriving at the age of twenty-one years may own at that time, may be surrendered to the company, and he shall be entitled to receive from the company in exchange therefore, a like number of shares of common stock, and for that purpose the surrendered preferred stock shall be re-issued as common stock.

The Secretary of State in some states, however, is reluctant to file charters containing clauses couched in anything other than the traditional, impersonal and rather stereotyped charter language.

Sometimes lawyers want to authorize shareholders and directors to act informally and without meetings. According to traditional doctrine, neither shareholders nor directors can act except at duly called meetings.¹⁷⁵ As a matter of fact, however, most family corporations and other closely held companies rarely hold the meetings required by law or follow the conventional formalities of the corporate ritual. Further, as directors and shareholders are usually the same people, they do not differentiate clearly between what they do in one capacity and what they do in the other. A failure to comply with corporate formalities is probably further encouraged by (1) a desire to expedite the operation of the business and avoid unnecessary expense and (2) a feeling that as the business is really owned by the

172. See pp. 46-51 *infra*.

173. See p. 5 *supra*. In *Orme v. Salt River Valley Water Users' Ass'n*, 25 Ariz. 324, 217 Pac. 935 (1923), the court upheld a charter clause which set up a thirty member council and an eleven member board of governors for a corporation and provided that three members of the council and one board member were to be elected from each of ten reservoir districts by shareholders located in the particular district. Each shareholder was entitled to one vote for each share held but not to a total of more than 160 votes. Further, each voter must have owned his shares for twenty days before the election and had to be at least twenty-one years of age and of sound mind. See also *Group Property, Inc. v. Bruce*, 248 P.2d 761 (Cal. App. 1952) (charter designated individual to be manager and supervise and direct corporation's business); *Lehmaier v. Bedford*, 99 Conn. 468, 121 Atl. 810 (1923).

174. 34 Wash. 2d 39, 208 P.2d 150 (1949).

175. BALLANTINE, CORPORATIONS §§ 119, 145 (2d ed. 1949). A waiver signed after the meeting cannot cure the defect. *Hill Dredging Co. v. Risley*, 18 N.J. 501, 114 A.2d 687 (1955).

managers there is no real need to follow practices designed to protect nonmanager owners.

In view of this tendency of participants in closely held enterprises to disregard the corporate ritual, lawyers might well consider ways of giving legal effect to the informal practices actually followed. One approach is to provide in the charter that any action that may be taken at a meeting of shareholders or directors may be taken without a meeting if authorized by a writing signed by all persons who would have been entitled to vote at the meeting.¹⁷⁶ Another approach is to authorize directors as well as shareholders to vote by proxy.¹⁷⁷ Even these approaches do not take care of some common practices, such as making decisions over the telephone.

The validity of charter provisions providing for informal action is subject to some question. In *Audenried v. East Coast Milling Co.*,¹⁷⁸ decided in 1904, the New Jersey court held invalid a charter provision that any resolution in writing signed by all the members of the board of directors would constitute action by the board. This holding was in the face of a New Jersey statute which provided that the incorporators might insert in the charter any provision they might choose for the conduct of the affairs of the corporation or any provision creating, defining, limiting, and regulating the powers of the directors, provided the provision was not inconsistent with the corporation act. Among other things, the Act provided that the business of every corporation should be managed by its directors and that the secretary of a corporation should keep a record of the directors' votes.

Most modern courts quite likely would refuse to follow the *Audenried* decision. The reason frequently given for requiring formal action by shareholders and directors, e.g., that in a duly called meeting a minority has an opportunity to present their views and convince the others, is not sufficiently strong to overcome the need for flexibility in closely held corporations. In a number of decisions, even in the absence of a statute or charter provision authorizing informal action, acts of the directors without a meeting have been upheld. The courts seem particularly inclined to uphold informal director action if the directors have customarily acted informally.¹⁷⁹

176. In some Canadian provinces, British Columbia for instance, it is common practice to prepare minutes and mail them to shareholders or directors who approve and sign them.

177. "The articles may provide that any director absent from a meeting may be represented by any other director or shareholder, who may cast the vote of the absent director according to the written instructions, general or special, of said absent director." LA. REV. STAT. § 12:34 (1950).

178. 68 N.J. Eq. 450, 59 Atl. 577 (Ch. 1904), discussed p. 8 *supra*.

179. See *Sharon Herald Co. v. Granger*, 97 F. Supp. 295 (W.D. Pa. 1951); *Brainard v. De La Montanya*, 18 Cal. 2d 502, 511, 116 P.2d 66 (1941); *Gerard v. Empire Square Realty Co.*, 195 App. Div. 244, 187 N.Y. Supp. 306 (2d Dep't 1921); *Simonson v. Helburn*, 198 Misc. 430, 97 N.Y.S.2d 406 (Sup. Ct. 1950). *Mickshaw v. Coca Cola Bottling Co.*, 166 Pa. Super. 148, 70 A.2d

Several of the modern corporation acts permit, without regard to provision in the charter, both the shareholders and directors to take action informally by signing a written consent to the action.¹⁸⁰ Other recent acts permit informal action by shareholders but do not contain a provision authorizing such action by the directors¹⁸¹ and thus imply that the directors cannot act informally.¹⁸²

A possible danger in allowing shareholders and directors to act informally is that they may thereby lose the limited liability the corporate form ordinarily furnishes. Departures from corporate ritual may lead some courts to say that the corporation is a mere "alter ego," "simulacrum" or "instrumentality" of the shareholders and that therefore they should be personally liable for its obligations. At least enough of the formalities normally incident to corporate operation should be maintained to insure that persons dealing with the enterprise clearly understand that they are dealing with a corporation and not with the participants as individuals or partners.

One of the most important problems that faces the lawyer drafting incorporation papers for a closely held corporation is to provide for the resolution of stalemates. Deadlocks frequently occur among the shareholders and in the directorates of closely held corporations. Voting power is often so distributed that an eventual impasse is not only possible but probable. The chance of corporate paralysis is of course increased if individual shareholders are given the power to veto corporate decisions.¹⁸³

Neither the statutes nor the courts have provided a satisfactory answer for the deadlock problem.¹⁸⁴ Whatever solution is to be had must be in the incorporation papers or in shareholders' agreements. A clause might be inserted in the charter providing (1) that the corpo-

467 (1950). "[A]ction, concurred in by all [the directors, who owned all the shares], although separately, and not as a body, binds the corporation. We must recognize the fact . . . that they [closed corporations] are, in perhaps the majority of instances, conducted by officers and directors little informed in the law of corporations, who often act informally, sometimes without meetings or even by-laws. To hold that in all instances technical conformity to the requirements of the law of corporations is a condition to a valid action by the directors would be to lay down a rule of law which could be used as a trap for the unwary who deal with corporations, and to permit corporations sometimes to escape liability to which an individual in the same circumstances would be subjected." *Gerard v. Empire Square Realty Co.*, 195 App. Div. 244, 187 N.Y. Supp. 306, 310 (2d Dep't 1921).

180. *E.g.*, PA. STAT. ANN. tit. 15, § 2852-402 (5) (Supp. 1955); WIS. STAT. § 180.91 (1955).

181. *E.g.*, ILL. ANN. STAT. c. 32, § 157.147 (Smith-Hurd 1954); MODEL BUSINESS CORPORATIONS ACT § 138.

182. In jurisdictions in which the board cannot act informally inconvenience to the whole board can be avoided by setting up an executive committee with authority to act for the board.

183. See p. 33 *supra*.

184. See *Israels, The Sacred Cow of Corporate Existence: Problems of Deadlock and Dissolution*, 19 U. CHI. L. REV. 778 (1952); *De Capriles and Prunty, Corporations*, 30 N.Y.U. L. REV. 534, 547 (1955).

ration can be dissolved by the vote of one shareholder or the votes of a small percentage of the shares,¹⁸⁵ or (2) that any shareholder shall have the power to dissolve the corporation unless the corporation or the other shareholders purchase his shares at a specified price or at a price to be fixed by formula.¹⁸⁶ Aside from the question of the legality of provisions of this kind (and this is a serious question in jurisdictions with statutes which fix a stated vote for dissolutions), dissolution is hardly an acceptable answer if the business is prosperous or its prospects promising. As there is ordinarily no ready market for a minority interest in a closely held corporation, the breaking of a deadlock by some of the shareholders' selling out is usually not feasible. A possibility worth considering is the use of a charter clause providing that whenever the company becomes paralyzed by disagreements, an option to purchase the shares of minority holders accrues in favor of majority holders. Another possible solution is a charter provision for the arbitration of disputes resulting in deadlock.¹⁸⁷

In drafting charter clauses for a closely held corporation, the lawyer must keep in mind that most specimen clauses in the form books are designed to meet the needs of public issue corporations and therefore are not necessarily adapted to the problems of closely held corporations. Among the clauses that require special attention are those on the shareholders' rights to inspect corporate records and those on shareholders' preemptive rights.

Normally shareholders in a closely held corporation should be given greater rights to inspect the corporate books and records than is customary in public issue corporations. As a matter of fact, statutory and common law rights of inspection are not sufficient to meet the needs of the shareholder in a closely held corporation, particularly in jurisdictions requiring the shareholder as a condition precedent to inspection to establish that his motives are not "ulterior." He should have an unqualified right at all times (during corporate existence and after dissolution) to examine personally or by representative all corporate books, contracts, accounts, correspondence, memoranda and other records, and to copy those documents and records. Further, consideration should be given to requiring the president or some specified officer of the corporation to render on demand full information on all corporate matters to any shareholder or to the legal representative of

185. "If it is desired to restrict any election to dissolve to the will of a particular class or series of shares it is permissible to provide that only the holders of that class or series of shares shall be entitled to vote on or consent to any election to dissolve." Aspey, *Suggestions and Precautions in Drafting Articles of Incorporation*, in ORGANIZING AND ADVISING SMALL BUSINESS ENTERPRISES 162, 172 (Cal. Pract. Hand Book No. 2 1954).

186. See Winer, *Proposing a New York "Close Corporation Law,"* 28 CORNELL L.Q. 313, 333, 342 (1943).

187. See O'Neal, *Resolving Disputes in Closely Held Corporations: Intra-Institutional Arbitration*, 67 HARV. L. REV. 786 (1954).

any deceased shareholder or of any shareholder under legal disability.¹⁸⁸ All of this can be accomplished by charter provision.

The shareholder's right of inspection is especially important because a closely held corporation is not subject to Securities and Exchange Commission regulations, and often a closely held enterprise does not even employ independent certified public accountants or, if it does, it may limit the scope of their examination. Further, as shareholders in a closely held enterprise are usually also officers, each shareholder-officer should be in a position to learn what is going on in those parts of the business in which he is not personally engaged. At the same time, there is really no reason in a closely held corporation to restrict the right of inspection, because making records available to a few shareholders is not much of a burden and the risk of snooping by competitors is not great.

Similarly, preemptive rights of shareholders in a closely held corporation usually should not only be preserved but should be extended and strengthened. For instance, preemptive rights should be made applicable to stock issued for property as well as for money. This extension and strengthening of preemptive rights is in contrast with the practice in public issue corporations, where preemptive rights ordinarily are taken away or limited.¹⁸⁹

Most of the considerations that justify the elimination of preemptive rights in public corporations do not apply to closely held corporations, at least not to those with simple share structures. Preemptive rights may be a source of insoluble difficulties in a corporation with a complex share structure. In addition, a corporation with stock publicly held may often want to sell shares to officers or employees as an incentive, or it may want to purchase the assets of another business with shares of its own stock; obtaining the waiver of preemptive rights might be impractical in these situations. Preemptive rights do not create these problems in a closely held corporation. Preemptive rights are needed in a closely held corporation to protect the shareholder's proportionate interest in control, dividends and surplus. A shareholder's interest in a closely held corporation is likely to be proportionately greater than the individual interest of a shareholder in a public issue corporation. Usually the proportionate interest of a shareholder in a public issue corporation is insignificant to begin with, and therefore an increase in stock makes little difference to him; and if it does, he can buy additional shares on the market.

Control is more important to a shareholder in a closely held corporation than to one in a public corporation, because control in a closely

188. See Winer, *Proposing A New York "Close Corporation Law,"* 28 CORNELL L.Q. 313, 341 (1943).

189. See p. 31 *supra*.

held corporation means employment, and the loss of control may result in termination of employment. Issuance of new stock to some shareholders but not to others may throw out of balance an otherwise carefully formulated plan distributing control among the various participants.

A final reason for maintaining preemptive rights in a closely held corporation is that its growth is likely to be due largely to the energy and personality of its shareholders. Therefore they should be in a position to purchase new issues of the corporation's stock and thus share in its expansion and prosperity.

Preemptive rights may not fully protect a shareholder against dilution of his interest in the corporation because when new stock is issued he may not have the funds to exercise his rights. Thus, a lawyer preparing incorporation papers for a closely held corporation should consider alternative methods of protecting shareholders against that risk, *e.g.*, the use of a charter clause prohibiting without the unanimous consent of the shareholders any increase in the amount of capital stock or any allotment or reissuance of stock.

C. Clauses That Might Strengthen Democratic Processes in Corporate Government.

Charter provisions can probably be drafted which would strengthen democratic processes in the government of large corporations.¹⁹⁰ The charter, for instance, might require the dissemination of a great deal more information to the shareholders than is now the practice. It might require (1) the directors to furnish the shareholders at periodic intervals a complete report including certified financial statements and other relevant information;¹⁹¹ (2) the secretary of the corporation to furnish the names and addresses of all shareholders on request from the holders of a stated percentage of the shares; and (3) the secretary of the corporation to prepare and mail to each shareholder within a reasonable time after each shareholders' meeting a sort of post-meeting report containing a transcript of the proceedings of the meeting. Pro-

190. Trigger, *Corporate Democracy . . . Advantages to Management*, 4 *DICTA* 61 (1952-53), points out that corporations and their managements may benefit from expanded corporate democracy. He notes that observance of democratic processes by a corporation results in improved relations with the shareholders and the concomitant advantages of (1) a ready-made and receptive market for new stock issues, (2) a tremendous advertising program through word-of-mouth advertising by shareholders, and (3) an independent and effective lobby, working with management, for legislation favorable to the free enterprise system.

191. See CAL. CORP. CODE ANN. § 3006 (Deering 1953). Under the corporate reorganization subchapter of the Bankruptcy Act, a reorganization plan for a corporation with an indebtedness of \$250,000 or more must provide for inclusion in the reorganized company's charter of "provisions with respect to the making, not less than once annually, of periodic reports to security holders which shall include profit and loss statements and balance sheets prepared in accordance with sound business and accounting practice." 52 STAT. 895 (1938); 11 U.S.C. § 616 (12) (b) (1952).

vision could also be made for the preparation of separate statements by minority directors on issues on which they differ with the majority and for the distribution of these minority statements with annual or other periodic reports. Further, the establishment of regional meetings of shareholders would give shareholders in all parts of the country an opportunity to speak with company officials and ask them questions firsthand. In those jurisdictions in which cumulative voting for directors is not made mandatory by constitutional provision or by statute, a clause in the charter requiring cumulative voting is needed to give minority shareholders representation on the board and the information and protection against abuse that goes along with representation.

Other charter clauses that might be considered are provisions (1) strengthening and safeguarding the shareholders' preemptive rights so that they will be in a position to maintain their proportionate ownership in the corporation, (2) requiring directors to be shareholders, (3) requiring directors to attend a specified percentage of directors' meetings or forfeit their offices, (4) limiting the amount the corporation can spend in soliciting its own proxies, and (5) providing for the payment by the corporation of the reasonable expenses of a shareholder group that wins a contest with the management.¹⁹²

PRECAUTIONS THAT INCREASE THE EFFECTIVENESS OF OPTIONAL CLAUSES

The draftsman can take a number of measures that will increase the effectiveness of optional provisions and protect them against attack or circumvention. The more important of these precautions are discussed in the following paragraphs.

A. Necessity of Careful, Individualized Drafting.

Most optional provisions require careful, individualized drafting. Optional provisions should mold the corporate device to the needs of a particular business enterprise, and of course no two business situations are exactly alike. Clauses in standard form books can at most serve only as "idea guides,"¹⁹³ and specimen provisions on many matters that an imaginative draftsman might want to cover are simply not available in published form. Further, because of differences in the corporation statutes and in the attitudes of the courts in the various states, optional provisions useful in one state may not be satisfactory

192. The provision might go farther and require the corporation to reimburse any group of shareholders for printing and mailing expenses if they should succeed in electing one or more directors or if a resolution they proposed received over a stipulated percentage of the vote cast. *Israels, Corporate Democracy . . . Fundamental Elements*, 4 *DICTA* 11, 15 (1952-53), suggests that a statute requiring the corporation to reimburse such expenses might be desirable.

193. See PANTZER AND O'NEAL, *THE DRAFTING OF CORPORATE CHARTERS AND BY-LAWS* §§ 2.03-2.04 (1951).

in another. Thus, in many situations, there are no specimen clauses tested by long use and by judicial scrutiny for the draftsman to use.

The necessity of thoughtful and careful drafting cannot be over-emphasized.¹⁹⁴ In some instances, loosely drawn optional provisions have been interpreted so as to frustrate the intention of the draftsman, in fact to accomplish just the reverse of what he intended.¹⁹⁵ The draftsman must check carefully to see that the optional provisions that he uses tie in with the "boiler plate" in the charter. Courts consider a charter in its entirety, looking at all the language of the charter in determining the meaning to be given any portion of it.¹⁹⁶

Sometimes the form of the language in which a clause is couched (rather than its substance or effect) will determine whether or not it will be sustained. Thus, in *Aldridge v. Franco Wyoming Oil Co.*,¹⁹⁷ a Delaware court held invalid a clause in the charter which provided that no person should be elected a director against whom there should be cast the vote of 40% of the Class A stock; although under the Delaware statute, there was clear authority for obtaining the same result by wording the clause to give a specified percentage of the Class A shares "an affirmative right to express a choice or preference, not merely the right of negation."

B. Obtaining Unanimous Consent to Unusual Charter Provisions.

The risk that an unorthodox charter provision will be declared invalid is probably increased by dissent at the time of its adoption. Some courts may well be willing to sustain clauses which deviate from the normal corporate pattern if those clauses are consented to by all interested persons, but may be unwilling to sanction departures if there are dissenters.¹⁹⁸ There seems to be a tendency for courts to conclude that shareholders by unanimous consent can do as they please with the corporation as long as the rights of creditors are not prejudiced. Further, at least one court has refused to enforce against dissenting shareholders a charter amendment which it held to be binding on consenting shareholders.¹⁹⁹

194. The validity of clauses in corporate charters has been said to be determined "not by what has been done under them, but also by what may be done." *Kaplan v. Block*, 183 Va. 327, 31 S.E.2d 893 (1944).

195. See *Martin Foundation v. North American Rayon Corp.*, 68 A.2d 313 (Del. Ch. 1949) (charter provision which defined disqualifying interest of directors for quorum purposes interpreted so as to place broader disqualifications on directors than would have existed at common law).

196. See *Ellingwood v. Wolf's Head Oil Refining Co.*, 38 A.2d 743 (Del. 1944).
197. 24 Del. Ch. 349, 14 A.2d 380 (Sup. Ct. 1940).

198. Differences in treatment are discernible between unanimous shareholders' agreements and contracts entered into by less than all the shareholders. Compare *Matter of American Fibre Chair Seat Corp.*, 265 N.Y. 416, 193 N.E. 253 (1934); *Kassel v. Empire Tinware Co.*, 178 App. Div. 176, 164 N.Y. Supp. 1033 (2d Dep't 1917), with *McQuade v. Stoneham*, 263 N.Y. 323, 189 N.E. 234 (1934); *Manson v. Curtis*, 223 N.Y. 313, 119 N.E. 559 (1918).

199. See *Albrecht, Maguire & Co. v. General Plastics*, 256 App. Div. 134, 9 N.Y.S.2d 415 (4th Dep't), *aff'd mem.*, 280 N.Y. 840, 21 N.E.2d 887 (1939) (an

When a corporation is being formed, the participants can usually agree on what provisions to include in the charter. That is the preferable time to place optional clauses in the charter. Later, a proposal to insert a provision in the charter is much more likely to meet with objection. The lawyer should be especially cautious in amending a charter to insert an unorthodox provision over the dissent of minority shareholders. Further, rights may be acquired under an original charter that cannot be divested by charter amendment. For example, a charter amendment authorizing the removal or suspension of directors has been held ineffective to support the removal of a director in office at the time of the amendment.²⁰⁰

C. Protecting Optional Charter Provisions Against Repeal or Circumvention.

Many of the optional clauses used in corporate charters (such as provisions giving a shareholder a power to veto corporate decisions and provisions setting up cumulative voting or granting preemptive rights) are designed to benefit minority shareholders. Special care must be taken to safeguard clauses of this kind against repeal, amendment or circumvention by manipulations of majority shareholders.

Modern corporation acts provide for amendment of corporate charters by a vote of a specified percentage of the shareholders. In some jurisdictions, the votes of holders of a simple majority of shares with voting power are sufficient. Thus, majority shareholders who find their wishes frustrated by charter provisions granting rights to minority shareholders may resort to the relatively simple expedient of amending the charter.²⁰¹

In many jurisdictions, charter provisions can be protected against amendment by inserting in the charter a clause requiring unanimity or a high vote for charter amendment.²⁰² Most corporation acts

amendment to the certificate of incorporation cutting off shareholders' preemptive rights was effective to deprive consenting shareholders of their preemptive but did not bind shareholders who opposed the amendment).

200. *Petition of Singer*, 70 N.Y.S.2d 550 (Sup. Ct. 1947).

201. See *Silva v. Coastal Plywood & Timber Co.*, 124 Cal. App. 2d 276, 268 P.2d 510 (1954) (charter restrictions on transfer of shares validly removed by charter amendment pursuant to Nevada statute); *Maddock v. Vorclone Corporation*, 17 Del. Ch. 39, 147 Atl. 255 (Ch. 1929) (cumulative voting provision in charter validly eliminated from the charter by a simple majority vote as in other charter amendments). *But see Bechtold v. Coleman Realty Co.*, 367 Pa. 208, 79 A.2d 661 (1951) (by-law restriction on transfer of shares creates "vested rights" and cannot be amended without unanimous consent).

202. The safest approach is to require unanimity or a high vote to amend or repeal any charter amendment rather than to limit the high vote requirement to particular clauses. A particular charter clause can sometimes be circumvented by amending other provisions of the charter. Thus, a provision designed to give a shareholder a power to veto action by the directors can under some circumstances be frustrated by increasing the number of directors. There is also a danger that a particular charter provision requiring a high vote for specified charter amendments may itself be amended or repealed by a smaller vote. See *Sellers v. Bancroft & Sons Co.*, 23 Del. Ch. 13, 2 A.2d 108

authorize unanimity or high vote requirements for charter amendment.²⁰³ In some jurisdictions, however, a charter clause setting the vote for charter amendments higher than the statutory vote fixed for amendments might be held invalid. In those jurisdictions, it may be possible to guard against charter amendment by an agreement not to amend among the shareholders or by an agreement between the company and the shareholders.²⁰⁴

The lawyer also has to guard against the possibility that in exceptional situations an amendment of the by-laws will supersede a clause in the charter. In *Gow v. Consolidated Coppermines Corp.*,²⁰⁵ the court held that the Delaware statute makes the by-laws the controlling authority on the number of directors a corporation shall have and that a charter provision fixing the number of directors is superseded by a subsequent by-law increasing the number of directors.

The rights conferred on minority shareholders by special charter provisions may also be lost through the merger or consolidation of the corporation; or shareholders attempting to exercise their rights may be "frozen out" by the dissolution of the corporation and the formation of a new corporation without the minority shareholders or by the transfer of all or substantially all the corporation's assets to another company. The answer to this problem is to require approval of all or of a very high percentage of the shares for fundamental corporate acts such as merger, consolidation, capital increase or reduction, dissolution and the transfer of all corporate assets.

D. Deciding Whether to Place Provisions in Charter or in Some Other Instrument.

Before including optional provisions in a corporate charter, the lawyer preparing incorporation papers for a corporate client must weigh the advantages and disadvantages of alternative methods of accomplishing the desired objective. He must determine, for instance, whether to put a particular provision in the charter, in the by-laws, in a shareholders' agreement, or in two or more of those instruments. This decision is often difficult.

(Ch. 1938); cf. *Warren v. 536 Broad St. Corp.*, 6 N.J. Super. 170, 70 A.2d 782 (App. Div. 1950).

203. See, e.g., DEL. CODE ANN. tit. 8, § 242 (1953); N.Y. STOCK CORP. LAW § 37; PA. STAT. ANN. tit. 15, § 304 (1938).

204. "Moreover, the statutory right of holders of a majority of voting stock to amend the certificate of incorporation so as to increase the number of directors is absolute unless restricted by some contrary provision in the certificate of incorporation or unless prohibited by unanimous written agreement of all the stockholders." *Christal v. Petry*, 275 App. Div. 550, 90 N.Y.S.2d 620, 627 (1st Dep't 1949), *aff'd mem.*, 301 N.Y. 562, 93 N.E.2d 450 (1950). In *British Murac Syndicate, Ltd. v. Alperton Rubber Co.*, [1915] 2 Ch. 186, the court restrained a company from violating a contract not to alter its articles of association, the contract having been entered into by the company and a syndicate holding some of its stock.

205. 19 Del. Ch. 172, 165 Atl. 136 (Ch. 1933).

The corporation act or judicial decisions in a jurisdiction may dictate the document in which a particular clause must be placed. In some jurisdictions, the act clearly states that a specified type of provision may be inserted in the charter but makes no clear provision for its inclusion in the by-laws; in other jurisdictions, the act authorizes the use of a clause in the by-laws but does not mention inclusion in the charter.²⁰⁶

In some states, the part of the corporation act which lists items for inclusion in the charter is couched in language that lends some support to an argument that matters there authorized for coverage in optional charter clauses cannot be covered by a by-law provision or in a shareholders' agreement. Thus, the Maryland statute provides that the articles of incorporation "shall state—* * * (7) the restrictions, if any, imposed upon the transferability of shares of any class."²⁰⁷ Statutory language of this kind could conceivably be interpreted to mean that share restrictions elsewhere would be ineffective.

That a draftsman cannot safely assume that statutory authority to place a particular clause in the by-laws will also sustain the clause if it is placed in the charter is illustrated by the Delaware case of *Gow v. Consolidated Coppermines Corp.*²⁰⁸ In that case, although the charter fixed the number of directors at nine, the shareholders amended the by-laws to increase the number to fifteen. The question before the court was whether the principle of graduated authority (i.e., that the statute is supreme over the charter, the charter over the by-laws, and so forth) rendered ineffective the attempted increase in the number of directors. The court gave effect to the change, basing its decision on a statute which provided that the "number of directors

206. For instance, N.J. STAT. ANN. § 14:3-2 (1939) provides that the "power to make and alter by-laws shall be in the stockholders, but any corporation may, in the certificate of incorporation, confer that power on the directors;" while N.Y. GEN. CORP. LAW § 27 provides that "Subject to the by-laws . . . the board may make necessary by-laws." Similarly, the statutes of some states permit provisions to be made *in the by-laws* for the indemnification of directors for liabilities incurred by reason of service with the corporation. CONN. GEN. STAT. § 5129 (1949); R.I. Acts 1948, c. 2154. Other statutes permit in addition the inclusion of such provisions in other corporate documents, such as the charter, or a certificate filed pursuant to law, an amendment to one of these, or a resolution in a specific case. ME. REV. STAT. ANN. c. 49, § 23 (1954); N.J. REV. STAT. § 14:3-14 (Supp. 1944); N.Y. GEN. CORP. LAW § 63. "The board of directors may exercise all the powers of a corporation, except such as are conferred by law, or by the by-laws of the corporation, upon the stockholders." MASS. GEN. LAWS c. 156, § 6 (1932). Many corporation statutes provided that the duties of corporate officers may be fixed by the by-laws. See, e.g., UNIFORM BUSINESS CORPORATIONS ACT § 32(III); WYOM. COMP. STAT. ANN. § 44-116 (1945). DEL. CODE ANN. tit. 8, § 142 (1953) provides the corporate officers may be chosen by the directors or stockholders as the by-laws may direct.

207. MD. ANN. CODE art. 23, § 4 (1951). ORE. REV. STAT. § 57.311 (1953) provides: "(1) The articles of incorporation shall set forth: * * * (g) Any provision limiting or denying to shareholders the preemptive right to acquire additional or treasury shares of the corporation."

208. 165 Atl. 136 (Del. Ch. 1933).

which shall constitute the whole board shall be such as from time to time shall be fixed by, or in the manner provided in the by-laws."²⁰⁹ The court concluded that the statute was mandatory and made the by-laws the sole and exclusive repository of the power to fix and alter the number of directors. The court stated that the "by-laws take their superior authority over the charter in this particular matter because they operate under the superior mandate of the statute."²¹⁰ On the other hand, in *Lippman v. Kehoe Stenograph Co.*,²¹¹ a Delaware court held valid a charter clause giving the shareholders and directors power to hold corporate meetings outside of Delaware, even though the Delaware corporation statute stated that "meetings may be held outside of the state if the by-laws so provide."

Whenever a distinction is made in judicial decisions in the validity of a particular clause, depending on whether it is in the charter or in the by-laws, the charter clause is usually sustained and the by-law invalidated.²¹² Thus, in New York, the courts have held invalid a by-law which provided that the number of directors could not be increased or diminished by a vote of less than 90 percent of the shareholders,²¹³ but have sustained a clause in the certificate of incorporation which provided that the number of directors fixed by the certificate could not be changed except with the unanimous consent of the shareholders.²¹⁴ Similarly, in some jurisdictions, restrictions on

209. 36 Del. Laws 1929, c. 135 § 4.

210. 165 Atl. at 141. See also *Reen v. United States Cement Co.*, 36 Ind. App. 149, 73 N.E. 269, 271 (1905). The first sentence of ORE. REV. STAT. § 57.200 (1953) is rather oddly worded. It refers to a "majority of the number of directors fixed by the by-laws, or in the absence of a by-law fixing the number of directors, then of the number stated in the articles of incorporation."

211. 11 Del. Ch. 190, 98 Atl. 943 (Ch. 1916); 11 Del. Ch. 412, 102 Atl. 988 (Sup. Ct. 1918).

212. "The difference between a restraint upon alienating the shares in these associations, contained in the article, which must receive the assent of all the primary shareholders and by which all persons holding derivative interest must be bound, and a like restraint imposed by the agents of the association in the form of a by-law, which may or may not come to the knowledge of the shareholders, and which, if known, may be disapproved of by them, is very marked. A person may generally agree by express contract to any qualification of his rights of property not repugnant to the rules of law; but if another person undertakes to attach such qualifications in his behalf, he must show his authority for the act." *Bank of Attica v. Manufacturers and Traders' Bank*, 20 N.Y. 501, 505-06 (1859).

213. *Katz v. H. & H. Mfg. Co.*, 109 App. Div. 49, 95 N.Y. Supp. 663 (1st Dep't 1905), *aff'd mem.*, 183 N.Y. 578, 76 N.E. 1098 (1906). See also *Bond v. Atlantic Mercantile Co.*, 137 App. Div. 671, 122 N.Y. Supp. 426 (1st Dep't 1910).

214. *Ripin v. United States Woven Label Co.*, 71 Misc. 510, 145 App. Div. 916, 130 N.Y. Supp. 20 (1st Dep't 1911), *aff'd*, 205 N.Y. 442, 98 N.E. 850 (1912), discussed p. 10 *supra*. "Moreover, the statutory right of holders of a majority of voting stock to amend the certificate of incorporation so as to increase the number of directors is absolute unless restricted by some contrary provision in the certificate of incorporation or unless prohibited by unanimous written agreement of all the stockholders. Any by-law attempting to restrict such right is ineffectual and invalid." *Christal v. Petry*, 275 App. Div. 550, 90 N.Y.S.2d 620 (1st Dep't 1949), *aff'd mem.*, 301 N.Y. 562, 93 N.E.2d 450 (1950). *But cf. In re Boulevard Theatre & Realty Co.*, 195 App. Div. 518, 186 N.Y. Supp. 430, 432 (1st Dep't 1921) ("It is true that the foregoing cases had reference

the transferability of stock are somewhat less likely to be sustained if placed in the by-law than if placed in the charter.²¹⁵

Sometimes the lawyer will find that courts in a jurisdiction have upheld a particular clause in one instrument—either in the charter, in the by-laws or a shareholders' contract—²¹⁶ but that they have not passed on whether the same clause can be used in other instruments and have not given any clear indication of how they would hold if that question should arise. Under such circumstances, the lawyer may be wise to use the approved instrument.

Many corporation statutes, including most of the more modern ones, clearly specify some matters that may be included in either the charter or the by-laws. Perhaps representative of the type of statutory provision that gives the draftsman a clear choice is a section of the Oregon statute which provides that the "act of the majority of the directors present at a meeting at which a quorum is present shall be the act of the board of directors, unless the act of a greater number is required by the articles of incorporation or the by-laws."²¹⁷ Statutes giving a choice, however, are worded in a great variety of ways.²¹⁸ Sometimes a statutory section provides that specified matters may be covered in the charter but states that other specified matters may be covered in either the charter or the by-laws.²¹⁹ Other statutes grant a general authority to include provisions in the by-laws, using language quite similar to that used in some statutes to authorize optional provisions in the charter. The Missouri statute, for instance, provides that "the by-laws may contain any provisions for the regulation and management of the affairs of the corporation not inconsistent with law or with the articles of incorporation."²²⁰ A few statutes provide that the charter may contain "any provision which would be authorized to be included in the by-laws."²²¹ Thus, in most states, there will be reasonably firm legal authority for including a considerable number of clauses in either the charter or the by-laws, and the draftsman must weigh the respective advantages and disadvantages of the two before deciding in

to by-laws, and not to provisions [requiring directors to be elected by unanimous consent of shareholders] embodied in a certificate of incorporation. But the reasoning of those cases is likewise applicable to a certificate of incorporation").

215. See *In re Laun*, 146 Wis. 252, 254, 131 N.W. 366, 367 (1911); Comment, 18 IOWA L. REV. 88 (1932).

216. See *Leventhal v. Atlantic Finance Corp.*, 316 Mass. 194, 55 N.E.2d 20, 154 A.L.R. 260 (1944) (holding that the right given a shareholder by Massachusetts statute under specified conditions to petition for dissolution may be waived by contract).

217. ORE. REV. STAT. § 57.200 (1953).

218. See, e.g., ILL. ANN. STAT. c. 32, § 157.33 (Smith-Hurd 1954); N.Y. GEN. CORP. LAW § 63; OHIO REV. CODE ANN. § 1701.65(B) (C) (Baldwin 1953).

219. See, e.g., OHIO REV. CODE ANN. § 1701.63 (Baldwin 1953).

220. MO. REV. STAT. § 351.290 (1949).

221. See, e.g., MD. ANN. CODE art. 23, § 4(c) (1951).

which instrument to place the provisions.

A number of practical considerations must be kept in mind in making the choice. A charter is a public instrument and is generally open to public inspection while by-laws are not. The by-laws can usually be amended or repealed more easily and more quickly and with less expense than can the charter.²²² As charter provisions are relatively difficult of repeal and amendment, the charter ordinarily contains only provisions which are expected to be fairly permanent or which are designed to protect minority shareholders. Most matters of internal management are covered in the by-laws, because those matters should be subject to hasty change.

Many draftsmen consider it to be good practice to repeat in the by-laws some items covered in the charter, because the by-laws serve as a guide for the directors and corporate officers (especially the secretary) in the conduct of corporate activities. Repeating unusual charter clauses in the by-laws serves to keep directors and officers from forgetting or overlooking them.

Some statutes require the use of both charter and by-law provisions to achieve a desired result. A Rhode Island statute, for instance, states that the articles of incorporation may provide that the corporation "shall have a lien on all shares of a stockholder for assessments due from him or other indebtedness of the stockholder due to the corporation, enforceable in such manner as the by-laws shall provide."²²³ Other statutes contemplate that specified matters may be covered in the by-laws if authority to do so is given in the charter.²²⁴ Even in the absence of a statutory requirement, the draftsman may use both a charter provision and a by-law to achieve a particular result, setting forth the matter in a general way in the charter but providing flexibility by leaving details or limitations to be spelled out in the more easily amended by-laws.²²⁵ Similarly, he may use a provision in the charter that will tie in with, lay the foundation for, or help effectuate a shareholders' agreement or by-law.²²⁶ Even though the

222. In some states, shareholders can amend the by-laws but not the charter without obtaining approval of the directors. See *Gow v. Consolidated Coppermines Corp.*, 165 Atl. 136, 142 (Del. Ch. 1933).

223. R. I. GEN. LAWS ANN. c. 116, § 8 (1938). See also KAN. GEN. STAT. ANN. § 17-2803(H) (1949) (authorizing a charter clause setting forth the manner of adopting, altering and repealing by-laws).

224. See, e.g., WIS. STAT. § 180.32 (1955) ("The number of directors may be fixed by the articles of incorporation, or, if the articles of incorporation so provide, by the by-laws . . .").

225. A charter provision sometimes used is worded somewhat as follows: "The board of directors of the corporation is hereby empowered to authorize the issuance from time to time of shares of its stock, with or without par value, of any class, and securities convertible into shares of its stock, with or without par value, of any class, for such considerations the board of directors may deem advisable, irrespective of the value or amount of such considerations, but subject to such limitations and restrictions, if any, as may be set forth in the by-laws of the corporation."

226. The following is a charter clause of that type: "If (a) any two or more

lawyer does not plan to cover a particular item in the charter, he should at the time he drafts the charter give thought to what instrument he will use and how he will word the provision; otherwise he may find that he has not laid a proper foundation in the charter for covering the matter in another instrument and is precluded from doing so without a charter amendment.

Some draftsmen prefer to use shareholders' agreements rather than (or in supplement to)²²⁷ charter provisions to cover many matters, such as restrictions on the transferability of stock and the allocation of control among the various participants; and in many localities matters of that kind are nearly always covered by agreement among the shareholders rather than by charter provision. The principal reasons for this are probably the bulkiness of some of the provisions and the uncertainty of the draftsmen as to whether such matters can properly be covered in the charter.²²⁸ Perhaps too the fact that the charter is a public document tends to discourage the inclusion in it of some items. On the other hand, a few draftsmen use

stockholders or subscribers to stock of the corporation shall enter into any agreement abridging, limiting or restricting the rights of any one or more of them to sell, assign, transfer, mortgage, pledge, hypothecate or transfer on the books of the corporation, any or all of the stock of the corporation held by them, and if a copy of said agreement shall be filed with the corporation, or if (b) the incorporators or the stockholders entitled to vote shall adopt any provision of by-laws abridging, limiting or restricting the aforesaid rights of any stockholders, then and in either of such events, all certificates of stock subject to such abridgements, limitations or restrictions shall have a reference thereto endorsed thereon by an officer of the corporation and such stock shall not thereafter be transferred on the books of the corporation except in accordance with the terms and provisions of such agreement or by-laws, as the case may be."

227. "The best procedure would be to place arbitration clauses in both a pre-incorporation agreement and in the charter." William H. Neiman, *Proceedings at the Annual Meeting of the Section of Corporation, Banking and Business Law (Chicago, August 16-17, 1954)*, 10 BUSINESS LAW. NOV. 1954, p. 9, 38. For reasons for covering restrictions on the transfer of stock both in a pre-incorporation agreement and in the charter, see O'Neal, *Restrictions on Transfer of Stock in Closely Held Corporations: Planning and Drafting*, 65 HARV. L. REV. 773, 786-88 (1952).

228. Typical of the kind of provisions found in shareholders' agreements but considered by most draftsmen as inappropriate matter for the charter are the following clauses: "The shareholders shall at all times vote their shares so that:

- (A) The Board of Directors shall consist of six members, and two persons nominated by A, two persons nominated by B, and two persons nominated by C shall at all times be directors of the corporation so long as A, B and C hold stock in the corporation;
- (B) A, B and C shall be President, Vice-President and Vice-President, respectively, of the corporation so long as said persons hold stock, are active in the business, are reasonably able to perform and do perform their duties, and make the management thereof their principal business occupation; and
- (C) Said persons, as officers, shall be compensated at the ratio of one and one-third to one to one (1-1/3:1:1) respectively, until December 31, 1975, and thereafter equally."

Quotation of the above provisions here is not meant to imply that they are valid or specifically enforceable, even if incorporated in a shareholders' agreement to which all shareholders are parties. Provisions of this kind, however, are commonly placed in shareholders' agreements.

lengthy and detailed and even "personalized" provisions in the charter, and when those provisions have come before the courts they have usually been upheld.²²⁹

A reference to any unusual or unorthodox charter provision should be placed on each certificate of stock. Reference to certain types of charter provisions on each certificate is expressly required by statutes. The Uniform Stock Transfer Act provides that there "shall be no lien in favor of a corporation upon the shares represented by a certificate . . . and there shall be no restriction upon the transfer of shares so represented by virtue of any by-law of such corporation to such lien unless the restriction is stated upon the certificate."²³⁰ Similarly, notice of the high quorum and high vote requirements for shareholder and director action authorized by Section 9 of the New York Stock Corporation Act²³¹ must appear clearly on the stock certificates.²³²

Reference to an unusual charter provision should be made in stock certificates even if that is not required by statute. Although purchasers of stock are sometimes said to be presumed to have knowledge of what is in the charter, courts are much more likely to hold a purchaser of shares bound by an unusual charter provision if he actually knew of it or had an opportunity to learn of it before he purchased his shares.²³³

Conclusion

The lawyer drafting a corporate charter never approaches his task with a pristine mind. He sees his problem through the patterns and ways of thinking which prevail in his legal community. What he has done in the past in drafting charters and what his colleagues at the bar are now doing shape his thinking and limit his conduct. In other words, he is a creature of his legal culture, and in large part its practices are his practices, its methods his methods, and its impossibilities his impossibilities. Perhaps this partially explains the dull "sameness" of most corporate charters, which is in such sharp

229. See p. 37 *supra*.

230. UNIFORM STOCK TRANSFER ACT § 15. The Uniform Stock Transfer Act was adopted by all the states, but section 15 was deleted in two states and materially modified in two others. In spite of section 15, some cases have held that restrictions which had not been placed on the share certificates were nevertheless effective against persons with notice of the restrictions. *Doss v. Yingling*, 95 Ind. App. 494, 172 N.E. 801 (1930); *Baumohl v. Goldstein*, 95 N.J. Eq. 597, 124 Atl. 118 (Ch. 1924).

231. See discussion of that statute, p. 4 *supra*.

232. See also N.Y. STOCK CORP. LAW § 65; N.Y. PERS. PROP. LAW § 176.

233. See *Union Trust Co. v. Carter*, 139 Fed. 717, 719 (C.C.W.D. Va. 1905); *Lawson v. Household Finance Corp.*, 152 Atl. 723, 729 (Del. Sup. Ct. 1930). A New York court held invalid as "contrary to public policy" clauses in the certificate of incorporation which required a unanimous vote of shareholders to elect directors, "since it may work a fraud upon the public who may purchase such shares in ignorance of the certificate provisions in question." *In re Boulevard Theatre & Realty Co.*, 195 App. Div. 518, 186 N.Y. Supp. 430, 433 (1st Dep't 1921), *aff'd mem.*, 231 N.Y. 615, 132 N.E. 910 (1921).

contrast with the uniqueness and individuality of business enterprises and the infinite variety of their needs.

Whatever the reason, most draftsmen do not utilize the considerable freedom that modern corporation acts give them to mold the corporate device to the varying needs of American business enterprises. An examination of the charters now in use shows that most of them fail even to clear up uncertainties and "trouble spots" that in the past have proved fertile sources of litigation.²³⁴ A lawyer drafting corporate charters can by the use of optional clauses often clarify legal relationships in those shadowy areas in which the law is uncertain or provides no answer to problems or difficulties that can easily be anticipated. Further, by the use of optional charter clauses he can mold the corporate form until it is ideally suited to almost any business enterprise. If there is a business need for particular provisions to be included in the charter and the lawyer does not explore thoroughly the possibility of including those provisions, he is not adequately serving his client. By looking beyond the incorporation practices of his own locality, to see what is being done elsewhere, and by directing his thinking into fresh channels, the lawyer can often increase the usefulness of the corporate organization to the clients he serves.

234. See Hayes, *Authorization and Issuance of Capital Stock by the Iowa Corporation* (Part II of a Study of Iowa Incorporation Practices), 39 IOWA L. REV. 608, 634 (1954). "Judging by the articles examined, some recognize their opportunity and do take care of many of the uncertainties. A number, however, have not done this, and their articles contain seeds of future litigation which they well could have destroyed." Hayes, *Stockholders' Rights in the Iowa Corporation* (Part IV of a Study of Iowa Incorporation Practices), 40 IOWA L. REV. 459, 486 (1955).

