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THE NEED FOR SPECIAL CLOSE CORPORATION LEGISLATION IN ILLINOIS

Robert E. Ginsberg*

In this Article, Professor Ginsberg makes a plea to the Illinois legislature to enact comprehensive legislation to govern close corporations. The author attempts to define and analyze the major conceptual changes necessary for the enactment of such legislation and contends that partnership law should be integrated with corporation law in the formulation of a close corporation statute. In suggesting possible provisions in the areas of definition, control and dissolution, the author offers a critique of relevant portions of the proposed Illinois Close Corporation Act of 1975.

I. INTRODUCTION

About ten years ago the Supreme Court of Illinois in Galler v. Galler acknowledged the “definite, albeit inarticulate trend toward eventual judicial treatment of the close corporation as sui generis.”1 Observing that “several shareholder-agreements that have technically ‘violated’ the letter of the Business Corporation Act have nevertheless been upheld in light of the existing practical circumstances,”2 the court concluded that

[t]he practical result of this [trend], while liberally giving legal efficacy to particular agreements in special circumstances notwithstanding literal “violations” of statutory corporate law, has been to inject much doubt and uncertainty into the thinking of the bench and corporate bar of Illinois. . . .3

It was suggested in passing that perhaps “. . . a separate comprehensive statutory scheme governing the close corporation would best serve here. . . .”4

In the decade which has passed since the supreme court’s suggestion, several states have adopted the idea of a separate

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1. 32 Ill. 2d 16, 28, 203 N.E.2d 577, 584 (1965).
2. Id.
3. Id.
4. Id. at 30, 203 N.E.2d at 585.
comprehensive statutory scheme governing the close corporation. Others have opted for a more limited approach of adding or amending particular sections of their existing business corporation law to solve at least some of the problems peculiar to close corporations. Illinois has followed neither of these routes. It has done nothing. As a result, the doubt and uncertainty for close corporation planners pointed out by the court in Galler remain.

A single comprehensive statutory scheme, the Illinois Business Corporation Act, governs all Illinois corporations. No legislative recognition is given to the possibility that the problems of a corporation with a large number of widely scattered stockholders might be different than those of a corporation with few investors. Yet to suggest that the needs of the owners and managers of a close corporation are identical with those of a public corporation in areas such as protection of minority rights and management control devices is to refuse to recognize realities. While a holder of thirty-two percent of the common stock of a public business is probably in control of that business, a holder of a similar percentage of the stock of a closely-held business, absent specific control devices, may well have no control power whatsoever.

Most stockholders in public businesses are investors and specu-


7. For a good example of the failure of the ad hoc judicial approach to solving the problems of the close corporation as opposed to a comprehensive legislative approach, see Somers v. AAA Temp. Serv., Inc., 5 Ill. App. 3d 931, 284 N.E.2d 462 (1st Dist. 1972).


For such investors free transferability of shares is a necessity and any restrictions on transfer detract seriously from the value of the investment. On the other hand, investors in a closely-held business are usually actively involved in the affairs of the business and are therefore concerned about the identity of their fellow investors who are likely to have a substantial impact on the success or failure of the enterprise. To a shareholder in such a business, a restriction on transfer of shares, which enables each of the investors to exercise control over any change in the identity of his fellow owners, adds to rather than detracts from the value of those shares. These are but two examples of the many essential differences between close and public corporations—differences which have long been recognized by everyone except the state legislatures.

Illinois was at one time a leader in the area of business corporation legislation. When the American Bar Association sought to draft a Model Business Corporation Act in the late 1940's, it turned to the Illinois Business Corporation Act (IBCA) of 1933 for a base on which to build. In the ensuing years, other states have modernized their business corporation laws to give greater flexibility to business planners and to facilitate the desire of owners of closely-held businesses for an incorporated partnership, combining the favorable attributes of the partnership, such as selection of associates, flexibility of management structure, and a minimum of ceremony, with the best attributes of the corporation, particularly limited liability and continuity. During this period the unchanged IBCA has become archaic, especially in

11. 1 F. O'Neal, Close Corporation § 1.07, at 21 (1971).
12. Securities subject to restrictions on transfer because they have not been registered under section 5 of the Securities Act of 1933, 15 U.S.C. § 77(f) (1970), sell in a private placement for a price substantially lower than the identical security which is freely traded. Cf. E. Weiss, Registration and Regulation of Brokers and Dealers 60 (1965).
13. See note 11, supra.
16. It should be noted that some of the inflexibility was attributable to the constitutional requirements of cumulative voting and prohibition against non-voting shares. See Ill. Const. art. XI, § 3 (1870); Wolfson v. Avery, 6 Ill.2d 78, 126 N.E.2d 701 (1955).
the context of the close corporation. Since the vast majority of business corporations being formed and in existence today are small, close corporations, their problems should be of primary concern to the legislature.

Since the peculiar problems of doubt and uncertainty in planning for the close corporation have been acknowledged and clearly identified by the courts for more than ten years, the Illinois legislature should resolve them by establishing a special statutory scheme for close corporations. Yet, to date, the Illinois legislature has done virtually nothing. The most recent rejection of a close corporation act for Illinois, occurring just this year, indicates their continued reluctance to facilitate close corporation planning. One probable reason for this reluctance is that the only advocates of reform are legal scholars.

However, these restrictions have been removed from the Illinois Constitution of 1970 and the legislature now has full freedom to amend the IBCA. See Ill. Const. art. XIII § 6. See also Ill. Const. art. XIII, §6 (Smith-Hurd 1970) (commenting on the effect of the constitutional amendment).

17. Illinois is the only state which still prohibits non-voting stock. IBCA §14; 1 Model Bus. Corp. Act Ann. § 15, ¶3.03, at 361 (2d ed. 1971). It is also one of only two states, the other being Mississippi, that expressly prohibits directors from filling a vacancy on the board of directors. IBCA § 36; 1 Model Bus. Corp. Act Ann. § 38, ¶3.02, at 801 (2d ed. 1971).

18. While there are no available statistics indicating what percentage of the corporations which exist in this country are close corporations, there are studies which suggest that the overwhelming majority are close corporations. 1 F. O'Neal, supra note 11, § 1.02, at 5 n. 8. See also Tenny, The Potential of the Close Corporation: A Question of Economic Validity, 14 How. L.J. 241, 253-56 (1968).


Owners of close corporations are not concerned with how to change the law starting tomorrow. They want to form a corporation today and have neither the time, the resources, nor the incentive to seek a prospective change in the law. The primary objective of the owners is to enter into a corporate form allowing them certain liability and tax advantages, and which at the same time will be tailored to meet their needs with a minimum of formality, inconvenience, expense and risk. What they are really seeking is an incorporated partnership, and they want it today.22
If the present law suggests they cannot enter into the type of arrangement which will best meet their needs, they do not go to Springfield for a solution. They simply try to find a way to circumvent the law or enter into an alternative arrangement.

Since certain problems peculiar to public corporations recur in repeated transactions such as mergers, recapitalizations, formation and dissolution of subsidiaries, the allocation of resources for active participation in a statutory reform effort is justified in order to alleviate the problem prospectively.23 The owners of close corporations, however, have only occasional contact with the Business Corporation Act. Incorporation, merger and recapitalization are truly extraordinary transactions to such businesses. Because these owners are much more concerned with opening the doors of their business and keeping them open, they attach a low priority to allocating resources for legislative reform. As a result, there is no lobby for close corporation statutes.

A variety of additional factors have contributed to the reluctance of the legislature to free the close corporation from the strictures of traditional corporate norms. Historically, the legis-

lature has sought to protect several interests in a business corporation act. Probably, the most important of these are the rights of creditors and of minority, non-management shareholders.

The Illinois Proposed Act for Close Corporations, as well as the ideas to be developed subsequently in this Article, in no way weaken the protections presently afforded under the IBCA.\(^\text{24}\) A basic rule of corporate law, that the shareholders' interests must be subordinated to those of the creditors, is unaffected by the Proposed Act. Regardless of whether the close corporation is managed by a board of directors or by the shareholders directly,\(^\text{25}\) the corporation can only make distributions to its shareholders in the form of dividends or return of capital when it meets certain financial standards.\(^\text{26}\)

In practice, the Proposed Act strengthens the protections available under the IBCA. If the owners of a close corporation choose to manage the business directly without a board of directors, they acquire the statutory liabilities placed on the directors and consenting shareholders for improper distributions under the IBCA.\(^\text{27}\) Presumably there will be more shareholders than directors and therefore, the creditors will have more pockets to look to, including those of innocent non-management shareholders. Their shield of limited liability is thus somewhat less effective than it would be under the present act.\(^\text{28}\) In addition, the traditional practice of close corporation creditors to bargain for the personal guarantee of some or all of the shareholders before extending the corporation credit is not altered.

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\(^{24}\) See Proposed Act § 2(b).

\(^{25}\) Proposed Act §12, permits the close corporation to be managed by shareholders in lieu of directors.

\(^{26}\) Id. §2(b), makes it clear that existing solvency and surplus requirements for the payment of dividends, IBCA §41, the repurchase of shares, id. §6, or any other distribution of capital to the shareholders, id. §41 (a), remain applicable to close corporations.

\(^{27}\) IBCA § 42.1.-11. Creditors also continue to have other rights, such as the power to seek and compel liquidation in the event of insolvency. See id. § 86 (b).

\(^{28}\) Proposed Act §12 (a)(2). There is no limitation in the Proposed Act making only active shareholders liable. Thus both management and non-management shareholders are liable for improper dividends and distributions. Non-management shareholders could escape liability by registering their dissent and declining the proffered payments. IBCA §42.9. However, such a scenario is unrealistic in all except the most extraordinary cases. All shareholders would still have limited liability as to tort and contract creditors as long as no improper distribution has in fact been made.
The Proposed Act would also adequately protect the interests of voluntary and involuntary minority shareholders. The principal thesis to be advanced by this Article is that the thrust of a close corporation statute should be to grant the owners of the business the broadest possible flexibility in arranging how and pursuant to what terms the corporate interests are to be allocated and corporate central powers to be distributed. It has been suggested by one of the leading authorities on close corporations, Professor O'Neal, that the state provide, "self-executory protection for minority shareholders who have failed to bargain for special charter or by-law provisions or for protective clauses in shareholders' agreements."29 There is presently no provision in the IBCA which implements this suggestion. Furthermore, the courts' general application of the business judgment rule under the present law has had the effect of shielding the board of directors, the representatives of the minority interests, from attack by the minority in all but the most egregious cases.30

In discussing the protection of minority shareholders in the close corporation, a distinction must be made between voluntarily and involuntarily acquired interests. In the first situation, the investor, commonly known as the venture capitalist, is presumably a mature, reasonably sophisticated adult who does not need the state's assistance in the bargaining process. On the other hand, the involuntary shareholder, such as an heir or a personal creditor of a voluntary shareholder upon execution is apt to have interests which are different from his or her predecessor and is likely to lack the power to protect them. The IBCA affords the involuntary shareholder little protection unless the predecessor was powerful enough in the negotiating process to extract statutorily permissible devices for protection and control.31

29. 1 F. O'Neal, supra note 11, §1.14(c), at 74.
30. Id. at 75-76; Shlensky v. Wrigley, 95 Ill. App. 2d 173, 237 N.E.2d 776 (1st Dist. 1968).
31. IBCA §146. See generally Articles cited in note 38 infra, for a wide variety of devices a powerful predecessor could create to afford protection to an involuntary successor. However, the concern with minority shareholders has not centered on the problems of those whose predecessors took advantage of such devices, but on those who did not. The relevant question is, as viewed by Professor O'Neal, whether the state should afford those shareholders mandatory, not bargained for, protections against the majority. See 1 F. O'Neal, supra note 11, §1.14(c), at 77.
for involuntary liquidation at the behest of a minority shareholder in cases of oppression are a cumbersome, expensive and often impractical solution.\textsuperscript{32} The Proposed Act and the suggestions to be developed subsequently in the section on dissension and deadlock at least permit the parties full freedom to plan for future contingencies, such as the death of a shareholder.\textsuperscript{33} The question of whether the state should go further and afford such rights on a mandatory basis to involuntary shareholders is a debatable one.\textsuperscript{34} However, it is more desirable to allow the owners of the close corporation to provide for protections of involuntary shareholders as they prefer, rather than enforce a uniform rule which may be detrimental in certain cases.\textsuperscript{35} The parties are in a better position than the state to determine the treatment of potential heirs and others who could succeed to the shares by operation of law.

Another factor weighing against special treatment for close corporations appears to be the belief that this treatment will prevent businesses from gradually evolving into public corporations.\textsuperscript{36} If, in fact, it is desirable that close corporations gradually transform themselves into public corporations, a notion which would appear likely to trouble the nation's securities regulators, then it is true that the Proposed Act and other close corporation statutes are undesirable in that they tend to inhibit the process. However, it should be noted that these acts do not absolutely prevent a close corporation from becoming public. They only require that the transformation be effected by the shareholders pursuant to an orderly decision-making process. The owners would have to elect to forego the special treatment afforded close corporations and

\begin{itemize}
\item \textsuperscript{32} IBCA §86. See note 168 and accompanying text infra.
\item \textsuperscript{33} See generally notes 163-89 and accompanying text infra. Provisions such as those allowing the parties to permit any shareholder to compel dissolution by contract and providing the remaining shareholders the option to purchase the interest of the "dissolving" shareholder for fair value determined by negotiation or by the court, give minority and non-management shareholders a potentially powerful right to use in the bargaining process with the majority. PROPOSED ACT §§13-14. Such rights are not readily available under the present IBCA. See note 160 and accompanying text infra.
\item \textsuperscript{34} For a discussion of the view that it should be a mandatory provision, see Hetherington, supra note 23, at 22.
\item \textsuperscript{35} E.g., a uniform rule giving every heir the power to dissolve a corporation, subject only to the ability of the other parties to fund a buy-out, would be destructive.
\item \textsuperscript{36} See 1 F. O'Neal, supra note 11, §1.13(a), at 52.
\end{itemize}
adopt the regulatory scheme governing public corporations. This affirmative and orderly decision-making process required to transform a close corporation to a public corporation seems no more detrimental or impeding than the affirmative decision-making process required to change a partnership into a corporation.

It is true that a competent and creative lawyer can meet most of the needs of any particular group of owners of an Illinois close corporation by means of carefully drafted articles of incorporation, bylaws and shareholders agreements, which go over, under and through the strictures of the IBCA. It is also evident that the Illinois courts continue to show benevolent paternalism when dealing with close corporations by bending, stretching, or overlooking the letter of the statute in order to give effect to the legitimate expectations of the parties. Nevertheless, the fact remains that intricate planning and drafting is expensive and the lawyers' fees which such an effort demands are beyond the means of most small businesses and their owners. This problem is compounded when one of the owners of the business becomes dissatisfied and, noting the absence of clear legislative statement validating counsel's business plan, decides to repudiate the agreement, thereby submitting it to court review. While ultimately the court is likely to uphold the questioned agreement, bylaw, or article in the interests of furthering close corporations, as a practical matter, the time, expense, and ill will generated by the litigation are likely to doom the business. By the time the squabble is resolved by the courts, dissolution is often the only realistic solution.

37. PROPOSED ACT §7.
40. In several recent cases involving Illinois close corporations the ultimate solution has been to order the dissolution of the corporation involved. See, e.g., Gray v. Hall, 10 Ill. App. 3d 1030, 295 N.E.2d 506 (1st Dist. 1973); Compton v. Paul K. Harding Realty Co., 6 Ill. App. 3d 488, 285 N.E.2d 574 (5th Dist. 1972); Ward v. Colcord, 110 Ill. App.2d 68, 249 N.E.2d 137 (1st Dist. 1969). While it is not clear that either the court or the parties would have been able to achieve continuation of the business, if there were a comprehensive statutory scheme governing close corporations, it is at least possible that they would
This Article is yet another plea for separate, comprehensive legislation to govern the affairs of close corporations\(^1\) and an attempt to highlight and define some of the major conceptual changes which are necessary for successful legislation in the area. Since the close corporation has been accurately described as an incorporated partnership,\(^2\) partnership as well as corporation law should be considered in formulating the special statute for governing the entity. This Article, therefore, will integrate the Uniform Partnership Act\(^3\) as well as the IBCA into the ensuing discussions. Furthermore, references will be made to the Illinois Proposed Corporation Act in order to evaluate its potential effectiveness.

### II. DEFINITIONAL PROBLEMS

Logic dictates that if a state is to create a statutory scheme for governing the activities of close corporations, some attempt must first be made at defining the entity subject to the legislation. It is clear that the statute should not govern a corporation whose shares are actively traded in the public market, but should govern a corporation owned exclusively by one natural shareholder. Beyond these obvious extremes the term "close corporation," like "obscenity," seems incapable of precise definition. This inability to define for all purposes what is and is not a close corporation should not be used by the legislature, however, as an excuse for declining to enact a statute providing comprehensive treatment of its problems.\(^4\) Ignoring the ambiguities places the burden of

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1. See note 21, supra.
2. See generally Hornstein, supra note 22.
4. Folk, The Model Act and The South Carolina Corporation Law, 15 S.C.L. Rev. 275, 282-83 (1963). See also Wolens, supra note 21, at 820:

The New York Business Corporation Law of 1961 represents the culmination of five years of extensive law revision effort, and the expenditure of more than one third of a million dollars. It is interesting that in such a complete revision New York chose a unified corporate statute basically applicable to public and close corporations alike. The decision was apparently made because of the New York Law Revision Commission's articulated inability to arrive at a precise definition...
both definition and solution on the courts which must fill in those areas where corporation legislation has left gaps.\textsuperscript{45}

It is the author's position that it is possible to identify the socio-economic concept encompassed by the term with sufficient clarity to permit a statute to be drafted which will meet the needs of the conceptualized entity. There are two features which can be identified as clearly essential to the existence of a close corporation: (1) a strong indication of an intention that the securities of the corporation not be publicly distributed or traded; and (2) the presence in the articles of meaningful restriction on the free alienability of the corporation's shares.\textsuperscript{46} Special treatment as a close corporation should be offered only to those corporations which possess, at least, these characteristics.

\textit{The Closely-Held and the Closed Aspects of the Close Corporation}

In the past there have been numerous legislative attempts to define close corporation. For the most part these attempts have been based upon two of the traditional concepts associated with the close corporation: (1) that of the “closely-held” corporation where the corporation has a small number of shareholders, and (2) that of the “closed” corporation where membership is limited by means of restrictions on the transfer of shares, and so forth.\textsuperscript{47}

\begin{footnotes}
\footnote{of the close corporation which would clearly separate it from the publicly held enterprise (footnotes omitted).}

\footnote{45. Traditional notions of legal process suggest it is far better for the legislature to at least make an attempt at definition in order to provide the judiciary with some foundation on which to build. A court would be better able to fulfill the legitimate intentions of the parties and thus reduce doubt and uncertainty in planning when there is some indication of legislative intent rather than none at all. Cf. Chayes, \textit{Madame Wagner and the Close Corporation}, 73 Harv. L. Rev. 1532, 1549 (1960). \textit{See also} Israels, \textit{The Close Corporation and the Law}, 33 Cornell L. Q. 488 (1948).}

\footnote{46. This definition approximates, with one significant change to give recognition to the permanent closed nature of the close corporation, that adopted by the Illinois judiciary: "... a close corporation is one in which the stock is held in a few hands, or in a few families and wherein it is not at all, or only rarely, dealt in by buying or selling." Galler v. Galler, 32 Ill. 2d 16, 203 N.E.2d 577, 583 (1965) citing Brooks v. Willicuts, 78 F.2d 270, 273 (8th Cir. 1935).}

\footnote{47. 1 F. O’Neal, supra note 11, §1.04, at 7. Tennery, supra note 18, at 249. \textit{See also} 1 F. O’Neal, supra §1.07, at 21:}

\begin{itemize}
\item A close corporation typically has the following attributes: (1) the shareholders are few in number, often only two or three; (2) they usually live in the same
\end{itemize}
 Since there are probably many more closely-held corporations than closed corporations in this country, most attempts to define close corporations have tried to play, in whole or in part, some sort of numbers game. As early as 1907, England drew distinctions between "public" and "private" companies at the boundary between fifty and fifty-one members. A few American definitions of close corporations have also relied solely on numbers. Most definitions which use a numbers test however, usually include some additional limitations such as denying the corporation a public stock issue, or requiring some restriction on the transfer of shares. The transfer restriction requirements are an acknowledgment of the "closed" nature of a close corporation, whereas the primary thrust of these numbers tests is to try to make finite the notion that a close corporation is closely-held. While the latter might encompass the social concept of what a geographical area, know each other, and are well acquainted with each other's business skills; (3) all or most of the shareholders are active in the business, usually serving as directors or officers or as keymen in some managerial capacity; and (4) there is no established market for the corporate stock, the shares not being listed on a stock exchange or actively dealt in by brokers; little or no trading takes place in the shares (footnotes omitted).

49. McFadyean, The American Close Corporation and Its British Equivalent, 14 BUS. L. 215, 216-17 (1958). Cf. COMPANIES ACT OF 1948, 11 & 12 GEO. 6, c. 38, §28. Interestingly, the equivalents of U.S. close corporations in continental Europe, such as the German Gesellschaft mit beschränkter Haftung (GMBH), do not seem to be based at all on the number of shareholders but are similar to the closed corporation concept. Schneider, The American Close Corporation and Its German Equivalent, 14 BUS. L. 228 (1958). The same is true for the French equivalent of the American Close Corporation, the Société à Responsabilité Limitée (SARL). Rawlings, The French Company Law: Choice of Corporate Form Available to the Foreign Investor, 30 BUS. L. 1251 (1975). Both the French and German statutes have devices limiting the negotiability of shares in close corporations. France also has a requirement of approval of new shareholders by the vote of existing shareholders. Japan, with its Yugen Kaisha, as well as Canada, also have close corporation statutes. Kessler, The Statutory Requirement of a Board of Directors: A Corporate Anachronism, 27 U. CHI. L. REV. 696, 719 n.105 (1960).
50. See, e.g., P.R. LAWS CODE ANN. tit. 14, §1102(c) (1971) (11 shareholders); R.I. GEN. LAWS ANN. §7-1.1-51(d) (1969) (30 shareholders); WYO. STAT. ANN. §17-36.32(c),(d) (1965) (20 shareholders). Compare INT. REV. CODE of 1954, §1371(a), which defines a small business corporation for purposes of subchapter S of the Internal Revenue Code as one with one class of stock and not more than ten natural or estate shareholders.

51. See, e.g., DEL. CODE ANN. tit. 8, §342 (1974) (30 shareholders, no public offer by corporation, restriction on transfer); KAN. STAT. ANN. §17-7202 (Supp. 1972) (same); PA. STAT. ANN. tit. 15, §1372 (Supp. 1975) (same); TEX. BUS. CORP. ACT ANN. art. 2.30-1(A) (Supp. 1975) (35 shareholders, no public offer, restriction on transfer).
close corporation is, namely, a corporation which is owned by a small number of shareholders who theoretically live and work in relative close proximity, it gives no recognition to the relevant economic component of a close corporation.

From an economic viewpoint, a close corporation resembles an incorporated partnership more than a public corporation. While the owners of a public corporation are looking for an appreciation of invested capital through the labors of others, namely the management, the owners of a close corporation are seeking a return based on their own labors. Any notion of speculation on the appreciation of invested capital is at best secondary. Similar to the members of a partnership, the owners of a close corporation are primarily looking for income in the form of salaries, dividends, or other distributions. They expect some voice in the control of the business and are usually not content to permit others to have complete authority over the fate of their investment. Moreover, they contemplate liquidation of their investment in the close corporation as an extraordinary event, certainly not to be contemplated in the ordinary course, but which is likely to occur only in the case of death, termination and/or dissolution of the close corporation.

The presence of less than a given number of co-owners is irrelevant to these economic objectives and thus the status of a close corporation should not be determined by numbers. It is arbi-

52. 1 F. O'Neal, supra note 11, §1.07, at 21. The point should be made that a close corporation statute should be limited to corporations which are owned by natural shareholders, estates, family trusts and the like, or subsidiaries of such corporations. It makes no sense to permit a wholly-owned subsidiary of a public corporation which, of course, has only one shareholder, or a joint venture corporation owned by a small consortium of public corporations, to be subject to a system of regulation far different from that of the public parent or parents. Cf. Weiner, Proposing a New York 'Close Corporation Law,' 28 CORNELL L.Q. 313, 315 (1943). See also 1 F. O'Neal, supra note 11, § 1.06(a), at 15; INT. REV. CODE of 1954, §1371(a). Otherwise this loophole might give rise to the types of abuses which characterized the massive public utility holding company empires in the first third of the twentieth century. See generally W. Douglas, DEMOCRACY AND FINANCE 127-69 (1940). However, an exception might be considered to permit corporate venture capital investors to participate in close corporations so long as they did not participate actively in the management of the business.

53. Tennery, supra note 18, at 251.

54. Although it seems anomalous, there is a minimum number of partners needed to form a partnership, two. UNIFORM PARTNERSHIP ACT §6(1). Any number of persons, from one ad infinitum, can form and own a corporation. IBCA §§ 34, 46.
trary and absurd to require that a close corporation have less than \( X \) number of members, or to say that one which has one more than \( X \) number of members is a different entity which should be subject to a scheme of regulation designed primarily for large public corporations.\(^5\) Instead, the nature of a close corporation and its achievement of the stated objectives are dependent on the presence of an owners' agreement, embodying their expectations and an assurance that in the event of a dispute these expectations will be recognized and honored by the legal process.

Just as a numbers test defining the closely-held aspect of the close corporation appears inappropriate, attempts to define the closed aspect of the close corporation are also unsatisfactory. There seem to be two methods of defining the latter concept: the statutes either refer to the existence or lack thereof of a public market for the shares, and/or they require some kind of restrictions on the transferability of the shares.

Inclusion of a general provision restricting the public marketability for the shares of a close corporation is an attempt by the legislatures to link the small number of shareholders with the concept of the selective club. This type of provision, which several states have adopted,\(^6\) seems to presume that if there is no trading market there will not be a large number of shareholders. Moreover, if there is no trading market there will be such a small number of potential buyers that the non-selling owners can have an effective veto power over any potential buyer by simply outbidding that buyer or by enforcing a prior agreement.\(^7\)

However, this logic fails on two counts. First, a general provision that the shares not be publicly traded by the owners does not prevent the shares from being publicly issued by the corporation.

\(^5\) Some states have attempted to reduce the arbitrary nature of the numbers rule by establishing attribution rules similar to those of section 318 of the Internal Revenue Code, INT. REV. CODE of 1954, §318, which have the effect of reducing the numbers of shareholders. See, e.g., Tex. Bus. Corp. ACT ANN. art. 2.30-1(A) (Supp. 1975). The nature of such attribution rules simply highlights the arbitrary nature of a numbers test. The nature of the corporation does not change if one more shareholder of record exists than is permitted under the counting scheme arbitrarily established by the definitional statute.


\(^7\) Comment, Definition of the Close Corporation, 16 VAND. L. REV. 1267, 1269 (1963); Note, 75 HARV. L. REV. 852, 854 (1962).
Thus the corporation may issue shares or a shareholder may distribute to a large number of buyers without creating an active public trading market. The results will be a close corporation which is in reality not closely held. The existence or non-existence of a public trading market should not be the focus for defining the closely-held corporation aspect of a close corporation. Emphasis should center upon the question of public distributions of securities by either the corporation or any shareholder. The latter is an approach which several legislatures, as well as our British cousins have already partly recognized. The close corporation statute should acknowledge the traditional notion that a close corporation is one with a relatively small number of shareholders by requiring it to prohibit in the articles any public offering or distribution of the securities by the corporation or its security holders. The unresolved issue is defining "public offering, or distribution," something which neither the U.S. Securities and Exchange Commission nor state legislatures have been able to do with satisfactory precision. The practices of the

58. For example, suppose the sole owner of a large corporation decided, for political or social reasons, to have the corporation make a gift of one share of stock to each of the corporation's five hundred employees while retaining the remaining 99,500 shares for him/herself. It is hard to imagine even without restrictions on transfer that an active trading market would develop in such shares since they would be virtually without value. Nevertheless such a corporation would be a close corporation in a state such as Florida. FLA. STAT. ANN. §608.70 (2) (Supp. 1975). It would also be considered public by the Securities and Exchange Commission and be required to file periodic disclosure reports under section 12(g) of the Securities Exchange Act of 1934 unless an exemption was allowed. 15 U.S.C. §78(e) (1970).

59. See Dickson, The Florida Close Corporation Act: An Experiment that Failed, 21 U. MIAMI L. REV. 842 (1967). The author also points out the evils inherent in such vague terms as "generally traded" which are characteristic of statutory definitions of close corporation. See, e.g., N.C. GEN. STAT. §55-73(b) (1975) ("generally traded"); N.Y. BUS. CORP. ACT ANN. §620(c) (McKinney 1963) ("regularly quoted in an over-the-counter market"); S.C. CODE tit. 12 §16-22(c) (Supp. 1974) ("regularly traded").


61. ENGLISH COMPANIES ACT, 1948, 11 & 12 Geo. 6, c.38, §28(c).

62. If the question of public offering or distribution were left to Illinois law, a numbers test would probably be established. The Illinois Blue Sky law apparently fixes a public offering by its exemptive provisions as one which is not made to more than fifty persons in any twelve month period, and a public distribution seems to be one in which securities are not sold to more than twenty-five buyers in any twelve month period. Both of the foregoing are subject to fairly complex statutory counting adjustment rules. ILL. REV. STAT. ch. 121 1/2, §§ 137.4(G), (H), (M) (1973). In any case, the definition is unsatisfactory
Delaware legislature and those states which have followed the Delaware pattern of tying the definition of public distribution to whatever posture the SEC decides to adopt at any given moment, seems better than any available alternative despite the legitimate criticisms it has received.

The second failing of the “not generally traded” definitional approach is that it in no way acknowledges the closed membership, quasi-partnership attribute of the close corporation. There is nothing in such a definition which insures each of the owners a veto right with respect to any change of associates by addition or substitution. Yet this right is basic to the concept of a close corporation, just as is delectus personae (choice of person) a fundamental doctrine of partnership, recognized by the Uniform Partnership Act.

A close corporation statute should afford recognition to the fact that delectus personae is an equally crucial concept in defining a close corporation. It is this quasi-partnership aspect of a close corporation which clearly separates it from its public counterpart. Therefore while the shares of a public corporation must be freely transferable for economic reasons, the shares of a close corpora-
tion must *not* be freely transferable for economic reasons.

While the prohibition of public issue or trading of a corporation's securities is designed to insure the closely-held aspect of a close corporation, it does nothing to guarantee closed membership characteristics. It offers no protection against the possibility that a shareholder may, in a private sale, transfer his securities to an individual who is undesirable to the other shareholders. The most effective method, which several states have adopted in whole or in part,⁶⁷ to protect shareholders against such involuntary associates is to restrict each owner's right to transfer his shares at the time of issue in order to afford the other owners a veto power over any new business associate.⁶⁸ Therefore, the statutory definition of a close corporation should require the articles of incorporation to provide that the transfer of all shares of all classes, or of securities convertible into shares, or of securities with voting rights, be subject to one or more types of transfer restrictions,⁶⁹ which would be enumerated in the statute.⁷⁰

While the existence of an effective restriction on transfer of the shares is an essential prerequisite for treatment as a closed corporation, the restriction should not include the suggestion of some authors that all owners actively participate in or be related by blood or marriage to the management of the corporation.⁷¹ This

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67. See statutes cited in note 51, supra.
69. There seems to be no need to require any restriction on the transfer of straight debt securities, which have neither a conversion right nor absolute or contingent voting rights.
70. See notes 129-31 and accompanying text *infra* for an explanation of the types of restrictions.

A close corporation is a corporation in which the owners of all the voting securities are engaged in the management of the corporation.

1. Voting securities do not include those securities to which voting rights accrue only on the happening of a contingency.
2. Management means (a) active participation, apart from the exercise of voting rights, in the formulation of corporate policy or in the making of decisions which affect corporate policy, or (b) day to day duties involving supervision of corporate operations or personnel (footnotes omitted).

The author suggests that the application of this definition should be subject to family attribution rules similar to those of section 318 of the Internal Revenue Code, Int. Rev. Code of 1954, §318. Note, *supra*, at 1272 n.25.
requirement seems to be a needless restriction on financial planning for the close corporation since it eliminates the venture capitalist, who is recognized in the law of partnership as a limited partner who may invest but has no power to manage.72 There seems to be no reason to exclude these individuals from close corporations since the separation of ownership and management is not in inherent conflict with the concept of a close corporation.

In summary, the definition of a close corporation should be one whose articles contain a prohibition on the public offer or distribution of its securities and one whose articles restrict the free transferability of any shares or voting securities. These two characteristics effectively preclude the public corporation from electing close corporation treatment. The definition proposed herein assumes that the statute will afford the close corporation the option of choosing whether it wishes to be governed by the special statutory scheme or whether it prefers to conduct its business under the IBCA.73 In order to effectuate the purpose of a close corporation statute, which is greater planning flexibility, it is only natural that the close corporation be able to choose the governing scheme which will provide the structure best suited to its particular needs. Thus, treatment as a close corporation should be left to the discretion of all the owner-partners, since it is a fundamental concern and, like the adoption or alteration of a partnership agreement, should require unanimous consent.74 But, a unani-


74. J. Crane & A. Bromberg, supra note 65, at 276. Of course, the law permits amendment of a partnership agreement by less than unanimous consent where the partners have agreed on a lesser percentage in advance. The same rule should apply to a corporation choosing whether it should be treated as a close corporation. All owners should consent to the election unless the articles provide otherwise. However, if the owners provide for a lesser percentage, then no amendment to the articles changing the percentage required for an election is to be permitted with the approval of any smaller percentage. See, e.g., Kan. Stat. Ann. §17-7206 (Supp. 1972). Otherwise, there would be an obvious inconsistency, in as much as the percentage set to decide on close corporation treatment could be
mous shareholder vote for the special treatment is not the only consideration,75 lest the scheme be subject to potential abuse by public corporations through the formation of holding company subsidiaries.76 The electing corporation must still meet the definitional requirements.

The proposed Illinois Close Corporation Act contains appropriate provisions giving the close corporation the option to be subject to either the proposed Close Corporation Act or the IBCA,77 and provides a method for new78 or existing corporations79 to make the election. A close corporation under this proposal is defined as a corporation all of whose shares of each class are subject to one or more of a list of enumerated restrictions on transfer including: (1) the existence of a right of first refusal in one or more fellow shareholders or other persons; (2) the existence of the right in the corporation or any class of shareholders to veto any proposed transferee; (3) a prohibition on transfer of shares to any designated person or class of persons (e.g. competitors); (4) a prohibition of any transfer which would endanger the right to taxation as a small business corporation under subchapter S of the Internal Revenue Code; or (5) an imposition of "any other lawful restriction on transfer or registration of transfer of shares."80

The definition of a close corporation in the Proposed Act recognizes and protects, albeit not as clearly as it might,81 the closed nature of the close corporation. However, it does nothing to require the maintenance of the closely-held nature of such a busi-

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75. In contrast, the Maryland definition provides that a close corporation is one which determines that it is such by unanimous vote of its shareholders, which clearly states that it is such in its charter, and which identifies itself as such in its stock certificates. Md. CORP. AND ASS'N CODE ANN. §4-201 (1975). No requirements of prohibition of public issue of shares or transfer restrictions are imposed.

76. See note 52, supra.

77. PROPOSED ACT §2(a). Election implies a specific statutory procedure. See, e.g., DEL. CODE ANN. tit. 8, §§343-44. (1974); TEX. BUS. CORP. ACT ANN. art. 2.30-1(E) (Supp. 1975). See also Dickson, supra note 59, at 844-45.

78. PROPOSED ACT §4.

79. Id. §5.

80. Id. §3.

81. See notes 131-34 and accompanying text infra.
ness. There is nothing in the Act which prohibits the corporation or a shareholder from making a public offer or distribution of his shares without sacrificing the close corporation qualifications. It is therefore necessary to add a provision to the Proposed Act that a corporation be required to include in its articles a prohibition on public offer or distribution of its securities by either a securityholder or the corporation in order to qualify as a close corporation. This provision insures that the qualifying corporation be both closed and closely-held—a true close corporation.

III. Control of the Close Corporation

Once the close corporation is defined and identified, the initial problems which the shareholders face are how the business shall be managed and to whom the shares may be transferred.

A. Management

One of the most attractive features of the partnership is that it provides the owners with maximum flexibility in ordering the internal affairs of their common enterprise. They can structure the management in any way they desire, and no notion of public

82. Conceivably, a corporation could create a special class of shares, e.g. class Z and issue all shares thereof to its transfer agent for a nominal consideration. It could then provide in its articles and note on the certificates that all transfers of stock of any class are subject to approval by the holders of class Z. The corporation could then sell its shares to the public with the transfer agent approving each transferee by informal "vote" each time shares were bought or sold. See IBCA §147. The corporation would still be a close corporation under section 3(a) (2) of the Proposed Act, although vastly different from traditional notions of what a close corporation is supposed to be. The plan may sound strained, but strained plans have not been unknown to Illinois corporate planners in the past. See, e.g., Stroh v. Blackhawk Holding Corp., 48 Ill. 2d 471, 272 N.E.2d 1 (1971). Other examples can be thought of, although less probable, whereby a corporation could be or become public and have an active market in its shares while still meeting the definition of the Proposed Act.

83. The partnership is managed by the owners themselves pursuant to whatever management agreement they create. Uniform Partnership Act §18. See also Bernstein, Bernstein, Wile & Gordon v. Ross, 22 Mich. App. 117, 177 N.W. 2d 193 (1970); J. Crane & A. Bromberg, supra note 65, at 374. While in the absence of any agreement each partner has an equal voice in management and control, Uniform Partnership Act §18(e); Polikopf v. Levy, 55 Ill. App.2d 229, 204 N.E. 2d 807, cert. denied, 382 U.S. 903 (1965), the members have the power to alter the management arrangement according to their own preferences. Elle v. Babbitt, 259 Ore. 590, 488 P.2d 440 (1971).
policy will upset the bargain the owners have reached. The partnersh

er entity, however, has several major drawbacks; the owners are personally liable for the debts of the business,\(^4\) and the partnersh
er entity does not survive the death or bankruptcy of any of the partners.\(^5\) In order to avoid the possibility of certain adverse con

sequences flowing from these factors, partnerships often elect incorporation, and the close corporation is the result.\(^6\) Yet, the na

ture of the business has not changed; the same associates make and sell the same products. As partners they were perfectly free to agree among themselves how the business should be managed. Now that they are legally identified as a corporation, they still should be able to manage their internal affairs as they see fit. The state and the creditors have no greater interest in how the business is managed when it is transformed into a close corporation conforming to the statutory definition discussed above.\(^7\) The ability of the close corporation, like the partnership which preceded it, to pay its debts as they mature is determined by the entrepreneurial skills of the owner-managers.

Unfortunately, traditional notions of general corporate law do not accept this logic, and in the absence of legislative direction to the contrary the courts cling to these archaic views.

The law never contemplated that persons engaged in business as partners may incorporate, with intent to obtain the advantages and immunities of a corporate form and then, Proteus-like, become at will a copartnership or a corporation, as the exigencies or purposes of their joint enterprise may from time to time require.

If they adopt the corporate form, with the corporate shield extended over them to protect them against personal liability, they cease to be partners and have only the rights, duties and

\(^4\) Uniform Partnership Act §15; Bayles v. Bennett, 22 Ill.App.3d 144, 316 N.E. 2d 792 (4th Dist. 1974); J. Crane & A. Bromberg, supra note 65, at 334-35.

\(^5\) Uniform Partnership Act §§31(4)-(5); J. Crane & A. Bromberg, supra note 65, at 432-35. The agreement may provide for the continuation of the business despite the case of the death of a partner. Oneida State Bank v. Peterson, 226 Ill. App. 381 (2d Dist. 1922).

\(^6\) C. Israels & A. Hoffman, supra note 71, at 8.

\(^7\) See notes 44-70 and accompanying text supra. See also notes 24-35 and accompanying text supra.
obligations of stockholders. They cannot be partners *inter sese* and a corporation as to the rest of the world. 88

The legislatures are as adamant as the judiciary in elevating form over substance. The legislative direction in Illinois remains absolute. "The business and affairs of a corporation shall be managed by a board of directors." 89 No distinction is made between Commonwealth Edison and the corner drugstore. 90 If a corporation exists, it must have directors and those directors must manage its affairs. This requirement has value in the context of large public corporations and is in accord with the traditional notion that capital has hired management. 91 The resulting separation of ownership and management gives the state a legitimate interest in creating a system for protecting identifiable interests. Corporate hierarchy places the duties of protection and balancing of the shareholders', creditors', and employees' interests on the directors. It is they who decide whether creditor protection requires that no dividend be paid, 92 and who hire and fire officers. 93 The directors must, in the first instance, propose the fundamental management changes which will drastically affect the fate of the shareholders' investment. 94

While the requirement of a board of directors makes eminent sense in the context of a public corporation, it is not necessarily in the best interests of a close corporation where the investors may or may not have the need, means, or the desire to hire someone else to manage their capital. The state has no legitimate

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89. IBCA §34.
90. Actually, there is one minor distinction drawn in the IBCA between the corner drugstore and Commonwealth Edison, an Illinois corporation. Commonwealth Edison must have at least three directors since it has more than two stockholders. The corner drugstore on the other hand would only need to have as many directors as stockholders. IBCA §34. Consequently, the incorporated individual is required to go through the statutory requirement of electing himself a director to run his affairs.
92. IBCA § 41. See also id. §§41(a), 6.
93. Id. §43.
94. Id. § 61 (merger), § 72 (sale of assets). Obviously, fundamental transactions are subject to shareholder approval. However, unless the board of directors decides to propose a particular transaction, the shareholders do not have the opportunity to voice their opinion.
interest in protecting the parties from themselves, and in this context there is little a state can do to protect third parties, creditors, and non-owner employees, from the defalcations of the owner-managers beyond that which it has already done; namely, the imposition of personal liability on the wrongdoers. 95

If the requirement of a board of directors is adhered to for the close corporation one of two things will happen: either it will be ignored or it will be observed by meaningless formalities. 96 Since the directors will be those owners who wish to participate in management, the parties will go through the legal motions of corporate form, but they will attempt to preserve the attributes of a partnership by means of special provisions in the articles, bylaws, or in shareholders’ or directors’ agreements. 97 These agreements will insure that the traditional notion of the role of a board of directors, 98 as independent of and separate from the shareholders in its decision-making process, exists only on paper in the corporate minute books. Thus the parties will attempt to comply with the law by emasculating it.

These attempts to avoid the requirement of a board of directors can present a great variety of problems depending on the particular method employed. Although a survey of the close corporation control devices available and the vast amount of litigation which they have produced is beyond the scope of this paper, 99 two of the more common devices and problems should be mentioned in order to illustrate the impropriety of the director management requirement in this context. One is to fill the board of directors with nominees or “dummy” directors who can be relied on with-

95. See generally notes 24-35 and accompanying text supra.
97. Cary, supra note 38, at 430-33. See also O’Neal, supra note 38, at 118.
out formal agreement to do the bidding of the shareholder whom they represent. The traditional purpose of the board of directors is to act as a kind of "Platonic Guardian" of the generally conflicting interests of shareholders, creditors, and employees of the corporation. In the event that these parties are not afforded the protections of the business corporation law, the director is to be personally answerable.

Courts, however, have shown understandable reluctance in the context of a close corporation to hold nominee "dummy" directors liable for the defalcations of the "partner" directors, suggesting that the injured party should look to the latter for recompense. This is the general rule in Illinois. It is inconsistent to require a director to protect designated interests and then refuse to hold him liable in the circumstance where such protection is needed. These directors serve no legal purpose.

Another device used to comply with the requirement of a board of directors is to create a board but limit its freedom to act by shareholders' or directors' agreement or by bylaw or article. The IBCA is silent on the validity of such efforts, and it is difficult to predict the enforceability thereof. In the absence of a statutory provision to the contrary, shareholders' or directors' agreements which overly restrict the directors in their power to manage the corporation will be struck down by the courts. Any corporate

Again, this seems to be an area where the Illinois courts, at least sub silentio, have drawn two different rules of law respecting "dummy" directors, one for public corporations and one for close corporations.
103. H. Henn, Law of Corporations §275, at 543-45 (2d ed. 1970). See, e.g., Teich v. Kaufman, 174 Ill. App. 306 (1st Dist. 1912). A distinction must be drawn here between two types of agreements. Those which bind shareholders to act in a particular way as shareholders (e.g., vote for certain named persons as directors) are valid and will be upheld in the absence of fraud or breach of some fiduciary duty. ABA-ALI Model Bus. CORP. ACT §34 (1969); MODEL BUS. CORP. ACT ANN. 730 (2d ed. 1971); Ringling Bros.-Barnum & Bailey Combined Shows, Inc. v. Ringling, 29 Del. Ch. 610, 53 A.2d 441 (1947); Kantzler v. Bensing, 214 Ill. 569, 73 N.E. 2d 874 (1905); Trefethen v. Amazlen, 93 N.H. 110, 36 A. 2d 266 (1944); Note, Shareholder Pooling Agreements — Validity, Legality and Enforcement, 24 Ark. L. Rev. 501 (1971). However, agreements among shareholders which
planner is aware of the voluminous litigation dealing with the validity of agreements in this area. This difficulty is heightened by the fact that two separate lines of decisions have developed distinguishing the courts' treatment of public corporations and close corporations. Control agreements which would be invalid in the context of a public corporation are upheld by the courts if the business is a close corporation. In this regard the planner is left to surmise what the judicial reaction to his particular scheme may be.

A board of directors, with formal requirements of numbers, elections, etc., adds nothing of social or economic value to the owners, employees, or creditors of a close corporation. The mere existence of a board in the close corporation raises traditional concepts of independent discretion and fiduciary obligation which only serve to complicate what seems to the owners simple business matters. Routine partnership agreements respecting such matters as long-term employment contracts and future profit distributions suddenly become intricate legal questions when the partnership incorporates. A long-term employment contract providing that one partner shall be employed as president and general manager of the corporation may be viewed by a court as an impermissible infringement on the power of future boards of directors to fulfill the statutory mandate that "the officers of a corporation shall be elected by the board of directors."
Similarly an agreement by less than all of the partners to vote that future profits shall or shall not be distributed in the form of cash dividends under certain terms and conditions is clearly valid and enforceable unless in conflict with the partnership agreement. A like agreement among the same number of partners who opt for the corporate form, or an agreement among some shareholders that "their" directors will vote to declare certain dividends when legal, is at least potentially vulnerable to attack. A court might find that the agreement constitutes a restraint on the discretion of the directors in the area of dividends which is violative of public policy and therefore should not be judicially enforced.

57 Ill. 416 (1870), subject to the caveat that such an agreement might conceivably be characterized as a voting trust and hence be vulnerable under IBCA §30(a). It would seem that the same group of the shareholders should also be permitted to freeze those same directors as officers for some given period of time. Thus, if the designated directors were owner-partners, they would be assured without risk of termination in the event of a falling out, that at least part of the return to them would be deductible salary for some definite period of time (a crucial distinction to the owners of a non-subchapter S corporation). If they were non-owners, the corporation could offer sufficient security in the form of a long-term employment contract to attract capable management. See Cary, supra note 38, at 434. While both of these seem to be legitimate business goals neither the legislature nor the courts has done much to aid the shareholders of close corporations in this regard.

Where the shareholders and the directors are identical, a contract between them and a particular director granting him a position as an officer for ten years would probably be binding on the parties. Fitzgerald v. Christy, 242 Ill. App. 343 (1st Dist. 1926). However, if the identity of the shareholders and/or the directors changes, the validity and enforceability of the agreement becomes more doubtful. Although it is binding on the original parties, the agreement among all of the stockholders "might not have bound the board of directors afterwards elected. . . ." Kantzler v. Bensinger, 214 Ill. 589, 598, 73 N.E. 874, 878 (1905). In Kantzler, although the court upheld a long-term employment agreement among all the shareholders, it made an observation which can hardly be comforting to the close corporation planner. "[I]t will be time enough to consider the rights of subsequent stockholders and creditors of the corporation when they are before us complaining." Id. at 600, 73 N.E. at 878. When "they" came before the court in Teich v. Kaufman, 174 Ill. App. 306 (1st Dist. 1912), Kantzler was carefully distinguished on the ground that it governed only when all of the stockholders were parties to or aware of the illegal long-term employment agreement. Id. at 314. See also West v. Camden, 135 U.S. 507 (1890); Amos v. Helwig, 19 Ill. App. 2d 220, 153 N.E. 2d 245 (1st Dist. 1958); People v. Pyle, 235 Ill. App. 532, 544 (3d Dist. 1924). But see Galler v. Galler, 32 Ill. 2d 16, 203 N.E. 2d 577 (1964) and Thompson v. Thompson Carnation Co., 279 Ill. 54, 116 N.E. 648 (1917) (upholding agreements among less than all shareholders).

107. See J. Crane & A. Bromberg, supra note 65, at 366.

108. 1 F. O'Neal, supra note 11, § 5.16, at 56. Such an attack was made and rejected in Galler, 32 Ill. 2d at 33-34, 203 N.E. 2d at 586-87. However, the fact that it was rejected in the context of Galler does not mean that it might not be made successfully in other
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The uncertainty of the fate of otherwise legitimate shareholders' agreements in the close corporate context can be eliminated by two complementary statutory provisions, both of which appear in the Proposed Act. The first provides that the question of whether the business of the corporation is to be managed by a board of directors or pursuant to shareholders' agreement is to be resolved by the owners themselves in the articles of incorporation, by original inclusion or appropriate amendment, and not by the state pursuant to statutory fiat. If the owners decide upon a board of directors, the second statutory provision permits the precise scope of discretion exercised by the board to be determined by the shareholders. Consequently, the shareholders of circumstances. The statute still requires that the dividend policy of a corporation remains in the hands of the directors, IBCA §41, and an agreement among all or a controlling block of shareholders to restrict the power of the board in that area would certainly challenge the statutory policy. However, an agreement among shareholders that dividends be declared (when there are profits) embodied in the articles or bylaws will be enforced because it is part of the contract to which all shareholders subscribe. Cratty v. Peoria Law Lib. Ass'n, 219 Ill. 516, 76 N.E. 707 (1906).

109. PROPOSED ACT §§11, 12.
110. Id. §12.
111. Id. §11(c).

It is not necessary or appropriate, however, that the provision be limited to only those agreements among all stockholders respecting the scope of directors' discretion. There is no reason why any number of shareholders should not be able to agree among themselves, in the absence of fraud, as to how "their" directors will act in a close corporation. See Del. Code Ann. tit. 8, §350 (1974).

Similarly, the problems created by long-term employment contracts, see note 106, supra, could be resolved by a simple provision specifying that agreements among any number of stockholders, or directors, and/or the corporation, whereby some individual should hold an office for an extended period of time, are valid and enforceable whether the person holding the office is a shareholder or an outsider. The Proposed Act would recognize and presumably permit specific enforcement of such agreements if entered into by all shareholders. PROPOSED ACT §§11 (a)(2),(3),(6). There seems to be no reason for limiting this to agreements among all shareholders. If the bylaws provide, for example, that shareholders shall elect the officers, id. §12, there seems to be no reason why an agreement among any number of shareholders to vote in a particular manner should not be enforceable so long as it is disclosed and does not work a fraud on the other shareholders. The Proposed Act, as presently drafted, would actually restrict the freedom available to owners of close corporations in the wake of Galler. Cf. Compton v. Paul K. Harding Realty Co., 6 Ill. App. 3d 488, 285 N.E. 2d 574 (5th Dist. 1972). See also Me. Rev. Stat. tit. 13-A, §§618 (1), (2) (1974), making agreements entered into by less than all the shareholders valid and enforceable among the parties. Such an additional provision would be advisable to clarify the agreement's validity and insure that it may be specifically enforced. Cf. Ringling Bros.-Barnum & Bailey Combined Shows, Inc. v. Ringling, 29 Del. Ch. 610, 53 A. 2d 441 (1947). A further caveat might be added prohibiting attack on such agreements in the absence of fraud by shareholders or directors not parties thereto.
a close corporation may choose to reserve for themselves such questions as dividend distribution or management contracts.

The effect of these provisions is to legislatively eliminate the archaic concept that a business cannot be a corporation to the world and a partnership to itself and its owners. The Proposed Act,112 as well as a considerable number of statutes in other states, has already accepted this concept.113 Such provisions “should demolish the mischievous heresy that the uninhibited control and management of the business and affairs of a corporation by a board of directors is part of the ‘essence’ of a corporation.”114 Thus, a few simple statutory provisions can achieve the same results as the intricate control devices which law teachers delight in teaching, lawyers take so much pride in creating, and clients are so unhappy paying for and perhaps ultimately litigating.

B. The Identity of the “Partners”

The identity of new partners in a partnership is entirely subject to the will of the existing partners. As a general rule, “the other partners cannot have a new partner thrust upon them without

112. PROPOSED ACT §11(b).
113. See, e.g., DEL. CODE ANN. tit. 8, §354 (1974); FLA. STAT. ANN. §608.75 (2) (Supp. 1975); S.C. CODE ANN. §12-16.22 (a) (Supp. 1974); TEX. BUS. CORP. ACT art. 2.30-2(A) (8) (Supp. 1975).
114. Bradley, supra note 21, at 1177. The close corporation statute should also legitimate all of the other control devices which might be appropriate, e.g., shares with extra or no voting power, voting only shares, voting debt securities, requirements of a super majority in any actions by directors and/or shareholders (including unanimous voting requirements) or permission for such actions to be mandated by minority approval. See generally notes 24-35 and accompanying text supra. For a fuller discussion of control devices, see note 38 supra.

By way of contrast, the Maryland close corporation statute is a model of unnecessary restraints which severely limit the abilities of the owners to achieve an “incorporated partnership.” While the statute specifically legitimizes unanimous shareholder agreements, Md. CORP. & ASS'N CODE ANN. §4-401 (1974), it does not invalidate agreements on the same subject matter simply because there is not unanimous consent. Id. §4-401(e) (providing that section 4-401 does not affect any otherwise valid agreement among stockholders). Because of the inherent ambiguity in section 4-401, the validity of non-unanimous shareholder agreements must still be determined by the court. The purpose of this provision should be to decrease litigation and to encourage shareholders to honor their agreements. In this regard, the statute obviously fails. There are other restrictive provisions of the Maryland statute which are equally inappropriate. Id. §4-301 (requiring a director, although only temporary); id. §4-502 (limiting the types of securities which close corporations can issue.)
However, the partners are free to vary this rule by agreement in any way they see fit. They may choose to provide in the partnership agreement that any transferee or class of transferees is eligible to become a partner upon transfer of a partnership interest or they may elect to prohibit any assignment of the interest. As in many other areas of partnership planning, the emphasis is on permitting the parties complete freedom to choose their associates. Since the state perceives no reason to intervene in this aspect of a partnership, it is strange that when the partners decide to incorporate, the state suddenly discovers that public policy requires a narrowing of the owners’ rights in determining the degree to which the interests in the business are to be transferable.

Many years ago Mr. Justice Holmes observed “[t]here seems to be no greater objection to retaining the right of choosing one’s associates in a corporation than in a firm.” However, an absolute prohibition in a bylaw or article on transfer of the interests of a close corporation without approval by some group of shareholders or the corporation is invalid in Illinois.

On the other
hand, a bylaw (or presumably a shareholders' agreement) which provides a restriction on the transfer of shares which is "not contrary to any positive rule of law or public policy, and provided the same were not unreasonable," would be upheld. The vagueness of this standard has promoted disputes and resulted in the collapse of many close corporations.

Absolute power in some person or entity to block transfer of stock offends public policy; whereas traditional buy-sell agreements, giving the corporation or certain of its shareholders absolute rights of first refusal do not. Between these two extremes, there is no bright line which will enable a draftsman to determine which restrictions on alienability will be permissible. For example, a price term in a buy-sell agreement, or a first refusal option or similar device, be it based on par, or book, or fixed price has been generally upheld by the Illinois courts, regardless of the "fairness" of the price fixed by the bylaw or agreement at the time of actual sale. However, that is not to say that all such


122. See cases cited in note 120, supra.


124. Section 8-204 of the Uniform Commercial Code, provides, "Unless noted conspicuously on the security a restriction on transfer imposed by the issuer even though otherwise lawful is ineffective except against a person with actual knowledge of it." This does nothing to alleviate the problem confronting the draftsman in deciding the validity of any contemplated restriction on transfer be it in the bylaws or shareholders' agreement, for two reasons. First, it only applies to restrictions "otherwise lawful"; it does not alter decisions such as Lake Sand Corp., see note 120, supra, recognizing "free alienability as an inherent attribute of securities" and condemning "unreasonable restraints on alienation." Uniform Commercial Code §8-204, Comment 2. Second, the section only applies to restrictions imposed by issuers, e.g., article or bylaw restrictions, and does not deal with private agreements among shareholders. Id., at Comment 4. See generally C. Israels & L. Gutman, Modern Securities Transfers 58 (1971).

125. For a discussion of the types of restrictions on transfers of shares available to planners of close corporations in order to insure delectus personae where possible, under existing statutory and judicial restraints see O'Neal, supra note 38, at 187. But see Cary, supra note 38, at 437. "Suffice it to say that there is no method of preventing the intrusion of outsiders as effective as the dissolution of a partnership."

126. See, e.g., Estate of Brown, 130 Ill. App.2d 514, 519-20, 264 N.E. 2d 287, 290-91 (2d
provisions would be upheld. It is obvious that one cent per share is tantamount to an absolute restriction on transfer of shares;\textsuperscript{127} however it is unclear how low a price must be in order for a court to reach this determination.\textsuperscript{128}

Dist. 1970) (court enforced a first option bylaw, despite a substantial disparity between the option price and fair market value).

The Illinois courts have consistently held that where a contract has been fairly entered into in good faith, and without fraud, concealment or overreaching, it may be specifically enforced in spite of a subsequent change in circumstances. . . .

In the instant case, there is no allegation or showing that the Stock Purchase Agreement was procured through fraud, unfairness or overreaching, or that it was somehow unfair at the time it was executed. . . .

Certainly the parties contemplated that the value of the Companies might change from time to time, and that book value could become an unrealistic yardstick . . . .

\textsuperscript{127} Cf. B & H Warehouse, Inc. v. Atlas Van Lines, 490 F.2d 818 (5th Cir. 1974); Palmer v. Chamberlain, 191 F.2d 532, 541 (5th Cir. 1951); New England Trust v. Abbott, 162 Mass. 148, 155, 38 N.E. 432, 434 (1894); 2 F. O'Neal, \textit{supra} note 11, §7.06, at 18. See also Systematics Inc. v. Mitchell, 253 Ark. 848, 491 S.W. 2d 40 (1973), refusing to enforce an agreement which would have required an employee to offer his stock to the corporation upon termination at a price of ten cents per share, when at the time of termination (for cause) the fair market value of the stock was fifty cents per share. The court relied on the prior Arkansas §64-211, No. 576, §26, [1965] Ark. Acts 2094 (amended 1973) which then validated transfer restrictions which "require a prior offering to the corporation or to one or more of its shareholders at a fair price. . . ." (emphasis added). The case is indicative of the traps which legislative use of words like "fair" or "reasonable" lay for close corporate planners when unhappy parties subsequently seek judicial relief from their own agreements. The Arkansas legislature recognized the folly of such provisions in the close corporation context when it amended section 64-211 in 1973 to provide that "[a]ny price, or formula for determining the price, set by said agreement or contract shall be deemed to be a fair price." \textit{ARK. STAT. ANN.} §64-211 (Supp. 1973).

\textsuperscript{128} There is a wide variety of methods for fixing the price terms, some of which, such as book value, may vary greatly in dollar amount depending on the financial condition of the business at the moment of the proposed transfer. \textit{See generally} Bradley, \textit{supra} note 68, at 156-60; 2 F. O'Neal, \textit{supra} note 11, §§7.24-.24(6). As a result the price fixed by agreement may approach or be zero and effectively preclude any transfer as where the price fixed is "book value" and the corporation has a negative net worth. In such circumstances, one could easily envision a court raising the cry of unreasonable restraint on free alienability to invalidate the bargain of the parties, and to force a new associate on the partners. However, it is worthy of note that one Illinois court, when confronted with such a problem, did decline to free the selling shareholder from his improvident contract and did require him to sell the stock for nominal consideration of $100 when it had no book value. Arensten v. Sherman Towel Corp., 352 Ill. 327, 185 N.E. 822 (1933).

Although drafting and planning of such restrictions is outside the context of this Article, it should be noted in passing that an agreement giving only the corporation, as opposed
Thus, in a close corporation statute any restriction on transfer embodied in the articles, bylaws, or agreement among any number of shareholders should be valid. There should be no limitation to "reasonable" restrictions; and what is reasonable is a question for the parties to answer by planning, not the courts to resolve by hindsight. It should also provide that all such articles, bylaws and shareholders' agreements are specifically enforceable at the behest of the corporation or any shareholder, but not necessarily at the behest of some other party in interest who relied thereon.

129. The Proposed Act seems to validate any "lawful" restriction on transfer in addition to those enumerated if such restriction is contained in the articles, PROPOSED ACT §3, or in a written agreement signed by all shareholders, id. §11(a) (4). The Proposed Act in §3(a)(2), overrules McNalta and its progeny, see note 120 supra, and in addition permits absolute restriction on transfer to avoid loss of subchapter S status, id. §3(a)(4). However, it is not clear why the restriction must appear in the articles or shareholders' agreement as opposed to the bylaws. Nor is it clear why a shareholders' agreement restricting transfer must be entered into by all, rather than some, shareholders. While it is obvious that an agreement (rather than article or bylaw) restricting transfer in some fashion would not be enforceable against a shareholder not a party thereto, the statute should make it clear that such agreement is enforceable against all parties thereto. See, e.g., DEL. CODE ANN. tit. 8, §202(b) (1974).

130. Words like "fair," "lawful," "unreasonably" leave the parties' plans to the vagaries of a court's review at some undefinable future date when circumstances may have changed drastically. Change is a risk all parties should consider in planning. Having presumably done so, one party should not be able to avoid that risk by contending that the contract is "unreasonable." See Arentsen v. Sherman Towel Corp., 352 Ill. 327, 185 N.E. 822 (1933). See note 127, supra for the disastrous Arkansas experience with the "fairness" standard. The Arkansas legislature, in removing the "fairness" standard took pains to observe the "substantial confusion and uncertainty" which such words had caused. ARK. STAT. ANN. §64-211.1 (Supp. 1973) citing Section 5 of Acts 1973, No. 409. The Proposed Act should also be changed to remove these vague terms in the context of stock transfer restrictions. PROPOSED ACT §§10, 3(a)(3). If the "reasonable" test is to remain, then section 10(a) of the Proposed Act should be changed to afford the opportunity to repurchase the shares to the corporation or its designee. See note 128, supra.

131. For example, an officer whose future employment is threatened by a change in ownership contrary to an existing shareholders' agreement to which he is not a party should not be able to specifically enforce the stock transfer agreement. On the other hand, he should be able to specifically enforce any employment agreement to which he is a party. See note 106, supra. The availability of specific enforcement is crucial to the viability of
While the state might have some perceived interest in maintaining free alienability as an inherent feature of securities to insure orderly functioning of capital markets, and protection of outside public security holders, it has no such identifiable interest in the context of the close corporation. Creditors are not affected by "unreasonable" transfer restrictions. The definition of close corporation precludes the existence of markets for such securities, so there is no marketplace to be disrupted by restrictions which the state considers "unreasonable." The only interest the state might have in interfering on behalf of present and future shareholders is to protect them from fraud or overreaching. This protection can be amply afforded by premising validity on the transmittal of prior notice to the shareholder who is to be bound thereby, whether the restriction is imposed on issue or subsequently by amendment. Thus, the notice concept of section 8-204 of the Uniform Commercial Code should be expanded to include not only transfer restrictions imposed by the issuer but those imposed by shareholders' agreement as well. A requirement of conspicuous notation of the transfer restriction on the shares should be sufficient to obviate the possibility of fraud or overreaching.

any control device in a close corporation and should be the preferred solution. See note 111, supra; Md. Corp. & Ass'n Code Ann. §4-401(d) (1975). However, it is probably not a good idea to require specific enforcement in all instances since the dissatisfaction generated by the dispute may doom the essential working relation of the "partner" shareholders and suggest dissolution as a preferable alternative. See Chayes, supra note 45, at 1532. 132. To complete the partnership analogy, any restriction on transfer to be imposed on issued and outstanding shares by article or bylaw amendment should require unanimous consent of all shareholders to be affected thereby. See Proposed Act §5. If unanimous consent is not obtainable, those shareholders who wish can at least bind the consenters by shareholders' agreement, provided the Proposed Act is changed as discussed in note 129, supra. See Del. Code Ann. tit. 8, §202 (b) (1974). 133. A restriction imposed by the charter or bylaws should be noted conspicuously on the face of the certificate, IBCA §21; Uniform Commercial Code §8-204. Different considerations apply to restrictions imposed by shareholder agreement. Such agreements should be in writing, id. §8-319(a). Cf. Smith v. Doctors Serv. Bureau, Inc., 49 Ill. App.2d 243, 199 N.E.2d 831 (1st Dist. 1964). As to their enforceability, see note 120, supra. 134. See Proposed Act §8. See also Md. Corp. & Ass'n Code Ann. §4.401(c) (1975).
IV. TERMINATION OF STATUS, DISSENSION AND DEADLOCK

Termination of Status

A comprehensive close corporation statute must also take into consideration the ramifications which will occur when a close corporation no longer meets its statutory definition. It must provide: (1) a means to remedy the disqualifying event and (2) an opportunity for the business entity to meet the requirements of the IBCA. While the Proposed Act contains elaborate provisions which are designed to govern involuntary termination, the language is unclear and the procedure is incomplete. The Proposed Act should be altered to clarify the consequences of involuntary loss of status and to outline the course to be followed thereafter.

Under the Proposed Act, any event which breaches a qualifying requirement with respect to restrictions on transfer or public distribution could cause the close corporation to be disqualified from special statutory treatment. A "breach" seems to be defined as a transfer of shares contrary to one of the several restrictions on transfer contained in the articles. Since only one qualifying restriction is needed for qualification, it is not clear why a breach of one restriction where several were included in the corporate arrangements and the others remain unbreached should cause a loss of status. A breach of one of several conditions is a matter of shareholder, not state concern. The state should only become involved when all qualifying restrictions on transfer are breached. Furthermore, if the suggestion of this Article with respect to public distribution is adopted a loss of status should also occur if these provisions are breached.

Prompt notice must be given to the shareholders of any event which creates a threat of loss of status as a close corporation. The corporation or shareholder is given ninety days from the time of notice of the disqualifying event, or if notice to all the shareholders is not given, one year from discovery "by the corporation, or a shareholder thereof, of said breach," in order to take advan-

135. See generally Proposed Act §9.
136. Id. §9(a).
137. Id. §§3, 8.
138. Id. §§9, 5.
139. Id.
tage of the broad equitable relief available under the statute to prevent a loss of status or obtain a restoration thereof. However the provision for a one year period after discovery by a shareholder is confusing. Does it include discovery by the transferee or the transferor who caused the breach? And by including discovery by the corporation, which will occur as soon as the transferee seeks to record the transfer on the books, the inevitable activation of the running of the one year period to the detriment of innocent, non-breaching shareholders is occasioned. The Proposed Act should be amended to continue the requirement that the corporation give immediate notice, but to make the statute of limitations ninety days after notice to the other shareholders or discovery by the other shareholders of the improper transfer.

When a shareholder of the corporation does not act within the statutory time period, the Act simply provides that, "the corporation's status as a close corporation under this Act shall terminate." The practical repercussions are far from clear. The Proposed Act does not indicate whether the corporation's certificate is automatically revoked, or whether further action is necessary by the state to obtain revocation of the charter. The latter course is probably what was intended by the Act, although the requisite action is not described. Despite the involuntary termination of status, the corporation should retain its certificate and remain de jure against all the world except the state. The impact of the alternative reading would be to impose unlimited personal liability on the shareholders, a penalty which seems contrary to the purpose of the statute intended to simplify the problems confronting close corporations and their owners.

Assuming that the corporation which has lost its status involuntarily is de jure against all except the state, the problem facing

140. Id. §9(b).
141. Id.
142. IBCA §82. Section 6(b) of the Proposed Act merely repeats that the effect of a breach of a qualifying condition results in the loss of status, but does not indicate the consequences of such involuntary termination.
143. IBCA §49.
144. Id. §146. See also Robertson v. Levy, 197 A.2d 443 (D.C. Cir. 1964). De facto corporation doctrine would not likely be available to protect the shareholders from personal liability since one of the elements of that doctrine, good faith attempt to comply with the state corporation statute, would appear to be missing. 1 IBCA ANN. 681 (3d ed. 1975).
the former close corporation is how to again achieve full corporate status under the IBCA. The area of principal difficulty will be in management. Whereas a qualified close corporation could be run by shareholders without a board of directors under the Proposed Act, all other Illinois business corporations must have a board of directors. Therefore, the close corporation whose status has been involuntarily terminated will have to be afforded a transitional period to remedy any defect under the IBCA. A means should be provided for other shareholders to compel a cure of managerial and other defects which prevent the former close corporation from complete compliance with the requirements for qualification under the IBCA. In addition, the Proposed Act should also be changed to require the corporation which has involuntarily lost its status to notify the state in order that the state might pursue quo warranto proceedings if appropriate. The Act presently provides for such notice only in the event of voluntary termination of status.

Dissension and Deadlock

Dissension and deadlock in the management of the affairs of a close corporation have long been associated with litigation and judicial dissolution of the business. Internal feuding and disagreement which paralyze the business are harbingers of inevitable dissolution since no other solution is possible under the IBCA. The only resolution of a dispute between the owners should not be a protracted court proceeding followed by liquidation of the corporation. Some less drastic alternatives should be available. The owners of a close corporation should be able to include in their business plan adequate provisions for the expedient resolution of internal squabbles. The state, which has an interest in avoiding economic loss, litigation, and unnecessary liquidation

146. IBCA §33.
149. See Levant v. Kowal, 350 Mich. 232, 244, 86 N.W. 2d 336, 342-43 (1957); "... [D]issension rarely, if ever, stands alone. It is usually accompanied by circumstances of financial loss, corporate paralysis, mismanagement and deterioration of property. ..."
should provide means to assist the parties in resolving their internal problems with an eye towards preserving the business as a viable entity.

It should be noted that deadlock, and dissolution are problems indigenous to the close corporation.\(^{150}\) While a large public business may endure brief periods of internal dissension, it is rare that the board of directors or shareholders will be deadlocked for any prolonged period of time. In addition, any dissatisfied shareholder in a public corporation may sell his shares in the market, an option not available to the owner of a close corporation whose right to sell is severely restricted.\(^{151}\) In the case of a partnership, any partner has the power to end a dispute by dissolving the firm at any time, despite a contrary provision in the partnership agreement.\(^{152}\) The dissatisfied partner can thereby force the other parties to the dispute to buy out his interest\(^ {153}\) and terminate the partnership relation.\(^ {154}\)

However, the very nature of the close corporation and the control devices used by the partner-managers, e.g., high quorum requirements, unanimous vote requirements and other veto devices\(^ {155}\) have a tendency to encourage dissension and deadlock. The mere existence of an even number of directors poses an ominous and continuous threat of paralysis to the business.\(^ {156}\) Under the control arrangements prevalent among most close corporations, a shareholder or a director who has been given a veto power is able to "embalm his corporation and hold it helpless . . . in a

\(^{150}\) 2 F. O'Neal, supra note 11, §9.02, at 3-4.

\(^{151}\) See notes 65-70 and accompanying text supra.

\(^{152}\) Uniform Partnership Act §31(2).

\(^{153}\) The value of his interest is decreased by any damages caused by the withdrawal and resulting breach of the partnership agreement.

\(^{154}\) J. Crane & A. Bromberg, supra note 65, at 426-30. Resolution of disputes and deadlocks in the partnership context, however, are often expensive and time consuming and result in substantial losses to the withdrawing partner. See also Chayes, supra note 45, at 1546 n.50.

Indeed, the partnership itself is not as fragile as is sometimes assumed. True, a partner can always withdraw. But monetary penalties can be embodied in the partnership agreement which exert a powerful suasion for the partners to patch up their difficulties. Similar techniques might well be employed by close-corporation planners.

\(^{155}\) 2 F. O'Neal, supra note 11, §9.02, at 168 n.6.

state of suspended animation.\textsuperscript{157}

Under the IBCA the dissatisfied shareholder in a close corporation is in a dilemma when dissension or deadlock arise. He cannot solve the problem by selling his shares, nor can he singlehandedly cause the dissolution of the corporation. Instead the IBCA provides for voluntary dissolution upon a vote of at least two-thirds of the shares entitled to vote thereon.\textsuperscript{158} A provision in the articles which purports to give any shareholder the power to unilaterally dissolve the corporation is probably illegal.\textsuperscript{159} The sole remedy afforded the unhappy partner-shareholder by the statute is to seek judicial liquidation.\textsuperscript{160}

It is true that the potential paralytic effect of a dispute can be obviated to a large extent by simple or intricate control devices to resolve dissension or deadlock. A detailed analysis of such devices is outside of the scope of this paper,\textsuperscript{161} but among the more common are buy-sell agreements, arbitration agreements, and contingent voting agreements.\textsuperscript{162}

\begin{footnotesize}
\textsuperscript{157} Kaplan v. Block, 183 Va. 327, 335-36, 31 S.E.2d 893, 896-97 (1944).
\textsuperscript{158} IBCA §76.
\textsuperscript{159} Id. §146 permits the articles to require a \textit{greater} vote than that required by the statute on any matter. It does not authorize the articles of a close corporation to require a \textit{lesser} vote than that required by the statute. \textit{See also} id. §31; Morel v. Hoge, 130 Ga. 625, 61 S.E. 487 (1908). \textit{Cf.} Moss v. Waytz, 4 Ill. App.2d 296, 124 N.E. 91 (1st Dist. 1955); Fitzgerald v. Christy, 242 Ill. App. 343 (1st Dist. 1926). There is no similar constraint on a partnership with respect to any matter, and there should not be such constraint on the members of a close corporation in ordering their internal affairs.
\textsuperscript{160} IBCA §86(a) gives a shareholder the right to seek liquidation when it appears:

\begin{itemize}
  \item [(1)] That the directors are deadlocked in the management of the corporate affairs and the shareholders are unable to break the deadlock and that irreparable injury to the corporation is suffered or threatened by reason thereof; or
  \item [(2)] That the shareholders are deadlocked in voting power and have failed, for a period which includes at least two consecutive annual meeting dates, to elect successors to directors whose term has expired or would have expired upon the election of their successors; or
  \item [(3)] That the acts of the directors or those in control of the corporation are, illegal, oppressive or fraudulent, or
  \item [(4)] That the corporate assets are being misapplied or wasted.
\end{itemize}


\textsuperscript{162} Agreements to arbitrate future disputes are clearly enforceable in Illinois, ILL. REV. STAT. ch. 10, §101 (1973), although an agreement to arbitrate disputes among directors as opposed to shareholders might well run afoul of restrictions on the erosion of directors discretion. H. Henn, \textit{supra} note 103, §277, at 546. In Delaware the election of a director by an additional class of shares created solely for the purpose of breaking the tie where
Predetermined methods for resolving disputes should be given effect if the result would be a solution to the problem. Several control devices are validated by the Proposed Act if approved by unanimous shareholder agreement. It is not clear why the requirement of unanimity is necessary. Any type of dispute resolution agreement among any number of shareholders should be valid as long as it does not work fraud upon the other shareholders. In addition, the Proposed Act provides the parties, and if necessary the court, with an effective and flexible system for resolving disputes and breaking deadlocks in unforeseen circumstances. The Proposed Act specifically legitimizes a provision in the articles or bylaws which grants to one or more shareholders the unfettered option to dissolve the corporation. The real import of this provision should arise in the context of dispute rather than deadlock. Under present law, the dissatisfied shareholder frustrated by legal or economic transfer restrictions and seeking dissolution, in the absence of deadlock, must prove to the court that the conduct of his co-owners, if not fraudulent or illegal, is "oppressive." Thus, the bargaining strength of the vetoless

the directors elected by the other class or classes are deadlocked, is valid. Lehrman v. Cohen, 43 Del. Ch. 222, 222 A. 2d 800 (1966). This device, conditioning voting power on the existence of a deadlock, would run afoul of Illinois' archaic mandatory voting provisions. IBCA §§14, 28. The Proposed Act should be changed to eliminate the Illinois requirement that all shares have full voting rights in close corporations in order to permit use of such devices.

163. See generally Proposed Act §11.

164. Id. §11(a).

165. Section 11(a)(5) of the Proposed Act provides that unanimous voting requirements can be changed; however, this change in itself requires unanimous shareholder agreement. Furthermore, it is unclear whether this section can be used to reduce the vote required on any given matter, as opposed to increase it. See note 159, supra.

166. See Symposium — The Close Corporation, 52 Nw. U.L. Rev. 345, 381 (1957). The state's only interest is to break the logjam.

167. Compare Proposed Act §13 with Del. Code Ann. tit. 8, §355 (1974). The Proposed Act makes one substantive change in the Delaware Act. The latter requires the grant of such power to a shareholder to be approved by unanimous vote unless the articles provide that such power may be granted upon a vote of two-thirds of all shareholders. Del. Code Ann. tit. 8, §355(b) (1974). The Proposed Act seems to require a unanimous vote in all cases. Proposed Act §13(b). But see note 159, supra.

shareholder who is unhappy with the policies of a majority of his fellow owners is far from strong. In fact, if the co-owners' activities are not "oppressive," and if normal close corporation stock transfer restrictions are in existence, the dissatisfied shareholder might be faced with a choice of accepting the policies of his "partners" or selling to them at bargain prices: a situation of which the other shareholders will be well aware in deciding whether to alter corporate policy to accord with the views of the dissenting colleague. On the other hand, if the dissenter has been granted an enforceable unfettered option to dissolve the corporation by the articles, the mere existence of such ominous power will be a crucial factor in helping the others see the wisdom of a negotiated sale or settlement.

The Proposed Act also gives the parties an important alternative remedy to dissolution in the case of disputes and deadlock which are presented to a court for resolution. While the court may still order dissolution, the shareholders, other than those who petitioned the court for dissolution, are entitled to avert the court-ordered liquidation by offering to purchase the dissident's

("oppressive or unfairly prejudicial either to the corporation or to any shareholder whether in his capacity as a shareholder, director, or officer of the corporation"). The word oppressive as used in the IBCA does not carry an essential inference of imminent disaster, but can contemplate a continuing course of conduct. The word does not necessarily savor of fraud, and even the absence of mismanagement or misapplication of assets does not prevent a finding that the conduct of the dominant director or officer has been "oppressive". . . . [E]vidence in the record showing an arbitrary, overbearing and heavy-handed course of conduct . . . [will] justify the finding of oppression. . . .

Compton v. Paul K. Harding Realty Co., supra, at 499, 285 N.E. 2d at 581. Thus "oppressive" is incapable of definition and "actions which might be oppressive under one set of circumstances would not be oppressive under others." Gray v. Hall, 10 Ill. App.3d 1030, 1034, 295 N.E. 2d 606, 609 (1st Dist. 1973). It would be more beneficial if the shareholders could make their own provisions for the effective resolution of disputes and dissension rather than having a court determine what is "oppressive". See generally Note, supra note 161.

While the Proposed Act permits involuntary dissolution based on dissension and deadlock, PROPOSED ACT §14, "oppressive" conduct would still presumably be a ground for court ordered dissolution since IBCA §86 is not clearly in conflict with section 14 of the Proposed Act and thus supplements it. PROPOSED ACT §§2(b), 15. The IBCA should be amended to remove the vague standard, such as "oppressive" conduct as a grounds for corporate dissolution. See, e.g., ME. REV. STAT. ANN. tit. 13-A, §1115 (1) (D) (1974) (eliminating word "oppressive" and using the words "illegal" and "fraudulent").

169. PROPOSED ACT §14 (a).
shares at court determined fair value.\footnote{170} This seems to partially codify existing case law which permits a court of equity to use its discretion and to give the parties a period of time to negotiate a sale or settlement before ordering liquidation.\footnote{171}

However, the Proposed Act makes important changes in the case law by giving the defendant shareholders an absolute right to purchase the shares of the plaintiff, and by requiring the court to fix a fair value in the absence of an agreement between the parties as to value.\footnote{172} This remedy, however, is limited to the situation where a shareholder without a contractual right to require dissolution at will or on the happening of a contingency, has sought involuntary dissolution pursuant to a court order. Yet, there seems to be no reason why the same right should not be afforded to the other shareholders in the situation where there is such a contractual right and it has been exercised. In these circumstances, the court should have the express power to convert an unfettered option to dissolve into a buy-sell if it appears to be in the best interests of all those affected.\footnote{173} The other shareholders

\footnotetext[170]{Id. §14 (b).}  
\footnotetext[171]{E.g., Ward v. Colcord, 110 Ill. App.2d 68, 249 N.E. 2d 137 (1st Dist. 1969). See also Duval v. Severson, 15 Ill. App.3d 634, 304 N.E.2d 747 (1st Dist. 1973) for another example of judicial remedy fashioning in the context of a dispute among close corporation shareholders.}  
\footnotetext[172]{PROPOSED ACT §14 (b). This provision affording some or any other shareholders the option to purchase the dissident's shares in lieu of judicially ordered dissolution is common in states which do not have a close corporation statute. E.g., CAL. CORP. CODE §4658-59 (West 1955); CONN. GEN. STAT. ANN. §33-384 (1960); MICH. COMP. LAWS § 450.1825(2) (d) (1973); ME. REV. STAT. ANN. tit. 13-A, §1123(3) (1974); N.C. GEN. STAT. §55-125.1 (1975); R.I. GEN. LAWS ANN. §7-1.1-90.1 (1969); N.J. REV. STAT. §14A: 12-7 (Supp. 1975); S.C. CODE ANN. tit. 12, §22.23(a) (Supp. 1974); W.VA. CODE ANN. §31-1-134 (Supp. 1974). See also ENGLISH COMPANIES ACT, 1948, 11 & 12 GEO. 6., c.38, §210. The California and West Virginia Code limit the right to majority shareholders. New Jersey affords the right to majority shareholders or the corporation. The Michigan Act permits the court to order the corporation or "the officers, directors, or other shareholders, responsible for the wrongful acts" to purchase the dissenter's shares at fair value. The English Companies Act empowers the court not only order the purchase of shares of the complaining shareholders, but authorizes it to "make such orders as it thinks fit . . . for regulating the conduct of the company's affairs in the future." Maine, North Carolina, South Carolina and Michigan follow the English Model and give the court wide latitude in framing alternatives to involuntary dissolution in cases of dissension and deadlock.}  
\footnotetext[173]{In making its decision whether to allow the dissolution of the corporation or whether to require a buy-out, the court should consider the interests of the employees, creditors and the other shareholders. In any case, the dissolving shareholder will still receive assets in the same amount and the same kind as if the option been left unchanged;
would then have the opportunity to purchase the shares of the "dissolving" shareholder at fair value, and to enlist the aid of the court, if necessary, in determining the value. Such a provision for an additional remedy in the contractual context would not limit the freedom of the parties to order their internal affairs as they see fit. The parties could still permit each other to act arbitrarily and the courts should still uphold the validity of such agreements. However, even if the corporation were in fact liquidated, all the dissenter would receive would be fair value. He should not be afforded the absolute right to dissolve the corporation at the cost of jobs and productivity for the sole purpose of satisfying vindictive instincts.

Surprisingly, and unfortunately, the Proposed Act omits several common statutory devices for resolving deadlock in the close corporation. One such device is the judicial appointment of a provisional director, an alternative which has been adopted by a number of states with and without close corporation statutes. It affords "a unique dispute settling arrangement with characteristics akin to those of compulsory arbitration, mediation, and conciliation." Although the statutes vary somewhat as to specific provision, the Delaware model is typical. It permits the appointment of a provisional director, notwithstanding a contrary bylaw, article, or agreement. The provisional director is appointed at the behest of either one-half the directors, one-third of the voting shares, or two-thirds of the shares of any class enti-

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177. 2 F. O'Neal, supra note 11, §9.30, at 121. See also Note, The Court Appointed Provisional Director for Deadlocked Corporations, 10 Wake Forest L. Rev. 635 (1974).

tled to elect a director, with a majority of shares or two-thirds of the class which sought the appointment being empowered to remove him by vote. The appointee must be impartial and not be a creditor or stockholder. Compensation and tenure are subject to court order or agreement unless, of course, the deadlock is broken and he is voted out. Once appointed, the provisional director has all the powers, including voting powers, of an elected director.

The concept of the availability of a court appointed provisional director as provided for in the Delaware Act is a good one and should be included in the Proposed Act. However, several important changes should be made in the Delaware model. First of all, the appointment should be left to the court to make sua sponte or at the behest of any interested party. The suggestion that the result of the availability of the appointment of a provisional director "will very probably be to make dissolution an almost inaccessible remedy" is founded on an assumption that the courts will apply the remedy indiscriminately, without considering the best interests of the corporation. One can assume that a court will not opt for a provisional director in lieu of dissolution in the face of a record which indicates that the owners' differences have occasioned such bitter feelings that they are no longer able to work together. However, the court should be empowered to appoint a sufficient number of provisional directors to break the deadlock if the articles or bylaws require more than bare majority vote for directors' action. Furthermore, if the owners of the close corpo-

179. Id. at §353(b). The parties can reduce the numbers required for standing to apply for a provisional director by article. See note 162 supra.


183. New Jersey permits the appointment of "one or more provisional directors," when such appears to be in the best interests of the corporation. N.J. Rev. Stat. §14A: 12-7 (3) (Supp. 1975). Delaware permits the appointment of "a provisional director . . . if the directors are so divided respecting the management of the corporation's business and affairs that the votes required for action by the board of directors cannot be obtained. . . ." Del. Code Ann. tit. 8, §353(a) (1974). Whether the court could make two or more such appointments to break a deadlock in the case where the close corporation articles or bylaws require a super majority for action is not clear, although the statutory
ration choose to eliminate the board of directors and provide for shareholder management, the court should be empowered to appoint a provisional "shareholder" equipped with enough votes to break a deadlock.\footnote{184}

Another typical close corporation statutory device which the Proposed Act omits is the authority for the court to appoint a custodian in lieu of a receiver.\footnote{185} The role of a custodian is akin to that of a trustee under Chapter X of the Bankruptcy Act;\footnote{188} the custodian is to attempt to rehabilitate the business by renegotiating the relations between the parties. He is to manage the business and preserve it for the benefit of the parties rather than liquidating it and distributing the proceeds as a receiver would do. Unlike a provisional director,\footnote{187} a custodian would be useful where the parties had provided that unanimous consent of all the directors or shareholders would be required for corporate action. Although a successful reconciliation is unlikely,\footnote{188} there is much to be gained by allowing a custodian to attempt to negotiate a settlement.

Since the state has a legitimate interest in breaking the deadlock and preserving the value of a solvent close corporation if possible, it should make available to the parties and the courts language seems to weigh against such authority. The California statutory provision differs from the New Jersey statute in that the former permits the appointment of a provisional director only when there is an even number of directors who are equally divided. CAL. CORP. CODE §819(a) (West 1955) In any case, the provisional director is useless in the situation where the deadlock is precipitated by a unanimous voting requirement.

\footnote{184} Although section 351 of the Delaware Code suggests such a result is permissible in theory, its application is difficult to imagine. DEL. CODE ANN. tit. 8, §351 (1974). If there is an even number of shareholders of a single class, a shareholder with one share could break the deadlock. But if there is more than one class of shares outstanding, and/or more than a single vote is required to break a deadlock, which class would the provisional shareholder manager hold and to how many votes in either or both classes would he be entitled?

\footnote{185} Compare DEL. CODE ANN. tit. 8, §352 (1974); N.J. STAT. ANN. §14A: 12-7 (Supp. 1975); VA. CODE ANN. §13.1-94 (1973). But see Fales, Judicial Attitudes Towards the Rights of Minority Shareholders, 22 BUS. LAW. 459, 463 (1967) (suggesting judicial authority to appoint a custodial receiver exists even in the absence of statutory provision); Holi-Rest, Inc. v. Treloar, 217 N.W. 2d 517 (Iowa, 1974).


\footnote{187} See note 183, supra.

\footnote{188} If, as is likely, the custodian is incapable of remedying the deadlock and dissen- sion, dissolution will result. See Slotsky v. Gellar, 49 Pa. D. & C. 2d 255 (C.P. Phil. Cty. 1969); 455 Pa. 148, 314 A.2d 495 (1974).
all the remedial tools suggested above. The parties and the courts can then determine the propriety of any device as a means of solving their particular problem.

**Conclusion**

Some of the ideas suggested in this Article will sound like heresy to traditionalists at the corporate bar. The concept of an incorporated partnership is in inherent conflict with some well-established concepts of corporation law, such as management by an independent board of directors and free alienability of shares. However, this Article has avoided several very radical notions which have been raised in the context of close corporations. For example, it has not adopted the suggestion that the close corporation be exempt from the traditional requirement that corporate owners make a firm commitment of a reasonable amount of capital to the business in exchange for limited liability.\textsuperscript{189} Furthermore, this Article does not incorporate the suggestion that contributions of such intangibles as future services should be recognized as an adequate substitute for the traditional requirement that capital contributions be in the form of cash or property.\textsuperscript{190} It would be unreasonable to expect the Illinois legislature to accept either of these more controversial ideas at this time. However it would not be unreasonable to expect the legislature to take its place among many of the more economically progressive states by giving legislative recognition to the fact that a close corporation is a unique entity requiring distinct legal treatment. Although the close corporation possesses some of the attributes of both partnerships and public corporations, it is unique with respect to the nature of its legal problems and its needs. The Proposed Act, with the changes suggested herein, would present an excellent means for beginning to alleviate these problems and accommodate these needs.

\textsuperscript{189} See Bradley, supra note 174, at 555.

\textsuperscript{190} Herwitz, Allocation of Stock Between Services and Capital in the Organization of a Close Corporation, 75 Harv. L. Rev. 1098, 1108-11 (1962).
APPENDIX
H.B. 1960

The following is a reproduction of the relevant portions of the proposed Illinois Close Corporation Act.

Section 2. Law Applicable to Close Corporation. (a) Unless a corporation elects to become a close corporation in the manner prescribed in this Act, it shall be subject to the provisions of The Business Corporation Act.

(b) All provisions of The Business Corporation Act shall be applicable to (1) all close corporations, as defined in Section 3 of this Act, except insofar as this Act otherwise provides, and (2) any close corporation that has voluntarily or involuntarily terminated its close corporation status.

Section 3. Close Corporation Defined; Contents of Articles of Incorporation. (a) A close corporation is a corporation organized under or electing to be subject to this Act the articles of incorporation of which provide that all of the issued shares of each class shall be subject to one or more of the following restrictions on transfer which restrictions shall be uniform within each class:

(1) Obligates a shareholder to offer to the corporation or to one or more shareholders of the corporation or to any designated person or to any combination of the foregoing, a prior opportunity to acquire such shares; or

(2) Requires the corporation or the holders of shares of any class of the corporation to consent to any proposed transferee of the shares; or

(3) Prohibits the transfer of such shares to designated persons or classes of persons, and such designation is not manifestly unreasonable; or

(4) Prohibits a transfer of the shares if the transfer would cause the corporation to lose its status as an electing small business corporation under subchapter S of the United States Internal Revenue Code; or

(5) Imposes any other lawful restriction on transfer or registration of transfer of shares.

(b) The articles of incorporation of a close corporation may set forth the qualifications of shareholders, either by specifying classes of persons who shall be entitled to be holders of record of shares of any class, or by specifying classes of persons who shall not be entitled to be holders of shares of any class, or both.

Section 5. Election of Existing Corporation to Become a Close Corporation. Any corporation organized under The Business Corporation Act may become a close corporation under this Act by amendment of its articles of incorporation which must be approved unanimously in writing or by the vote of the holders of record of all the outstanding shares of each class of the corporation.

Section 6. Limitations on Continuation of Close Corporation Status. A close corporation continues to be subject to this Act until:

(a) It files with the Secretary of State articles of amendment deleting from its articles of incorporation the provisions required by Section 3, or

(b) Any one of the provisions or conditions required or permitted by Section 3 of this Act to be stated in articles of incorporation to qualify a corporation as a close corporation has in fact been breached and neither the corporation nor any of its shareholders proceeds under Section 9.

Section 7. Voluntary Termination of Close Corporation Status by Amendment of Articles of Incorporation; Vote Required. (a) A corporation may voluntarily terminate its status as a close corporation and cease to be subject to this Act by amending its articles of incorporation to delete therefrom the additional provisions required by Section 3. Any such amendment must be approved in writing or by a vote of the holders of record of at least two-thirds of the outstanding shares of each class of the corporation.

(b) The articles of incorporation of a close corporation may provide that on any
amendment to terminate its status as a close corporation, a unanimous vote or any vote
greater than two-thirds of the shares of any class shall be required; and, if the articles of
incorporation contains such a provision, that provision shall not be amended, repealed or
modified by any vote less than that so required to terminate the corporation's status as a
close corporation.

Section 8. Issuance or Transfer of Shares of a Close Corporation in Breach of Qualify-
ing Conditions. (a) Every certificate representing shares issued by a close corporation shall
conspicuously set forth upon the face or back of the certificate a full statement of all the
restrictions on transfer and the qualifications of shareholders set forth in subparagraphs
(a) and (b), respectively, of Section 3 of this Act and the existence of a written agreement
permitted under Section 11 of this Act. Such full statement may be omitted from the
certificate if it shall be conspicuously set forth upon the face or back of the certificate that
such statement and written agreement, if any, in full, will be furnished by the corporation
to any shareholder upon request and without charge.

(b) Any person to whom certificates representing shares of a close corporation contain-
ing either statement required by subparagraph (a) of this Section 8 are issued or assigned
is conclusively presumed to have notice (i) of the fact of his ineligibility to be a share-
holder, (ii) that he has acquired shares in violation of a restriction on transfer allowed
pursuant to this Act, and (iii) of the provisions of a written agreement permitted under
Section 11 of this Act.

Section 9. Involuntary Termination of Close Corporation Status; Proceeding to Pre-
vent Loss of Status. (a) If any event occurs as a result of which one or more of the
provisions or conditions included in the articles of incorporation of a close corporation
pursuant to Section 3 hereof to qualify it as a close corporation has been breached, then
upon discovery by the corporation of such event, the corporation shall promptly notify all
of the shareholders in writing of such event and of the shareholders' rights under subpara-
graph (b) of this Section 9. If, within 90 days after such notification, the breach is not
remedied or a proceeding under subparagraph (b) of this Section 9 is not commenced, then
the corporation's status as a close corporation under this Act shall terminate. In the event
that all of the shareholders of the corporation are not so notified within one year after the
discovery by the corporation, or a shareholder thereof, of said breach, then the corpo-
ration's status as a close corporation under this Act shall terminate as of the last day of said
one year period, unless within said one year period the breach is remedied or a proceeding
is commenced under subparagraph (b) of this Section 9.

(b) The Circuit Court of the County in which the registered office of the corporation
is located, upon the suit of the corporation or any shareholder thereof, shall have jurisdic-
tion to issue all orders necessary to prevent the corporation from losing its status as a close
corporation, or to restore its status as a close corporation. The Circuit Court shall enjoin
or set aside any transfer or threatened transfer of shares of a close corporation which is
contrary to the terms of its articles of incorporation or of any transfer restriction permitted
by subparagraph (a) of Section 3 of this Act.

Section 10. Corporate Option Where a Restriction on Transfer of Shares is Held In-
valid. If a restriction on transfer of shares of a close corporation is held by the Circuit Court
in a proceeding pursuant to subparagraph (b) of Section 9 of this Act not to be authorized
by subparagraph (a) of Section 3 of this Act, the corporation shall nevertheless have an
option, for a period of 30 days after the judgment setting aside the restriction becomes
final, to acquire the restricted shares at a price which is agreed upon by the parties, or if
no agreement is reached as to price within such 30 day period, then at the fair value of
such shares as determined by the Circuit Court.

Section 11. Written Agreements as to Conduct of Certain Affairs of Corporation. (a)
All shareholders of a close corporation may enter into a written agreement, relating to any
phase of the affairs of the corporation, including, but not limited to, the following:

1. Management of the business of the corporation.
2. Declaration and payment of dividends or division of profits.
3. Who shall be officers or directors, or both, of the corporation.
4. Restrictions on transfer of shares permitted by Section 3 of this Act.
5. Voting requirements, including the requirements of unanimous voting of shareholders or directors.
7. Arbitration of issues as to which the shareholders are deadlocked in voting power or as to which the directors are deadlocked and the shareholders are unable to break the deadlock.

(b) No written agreement to which shareholders of a close corporation have actually assented, whether embodied in the articles of incorporation or by-laws of the corporation or in any separate written agreement and which relates to any phase of the affairs of the corporation, whether to the management of its business or division of its profits or otherwise, shall be invalid as between the parties thereto, on the ground that it is an attempt by the parties thereto to treat the corporation as if it were a partnership or to arrange their relationships in a manner that would be appropriate only between partners.

(c) If the business of a close corporation is managed by a Board of Directors, an agreement among all of the shareholders, whether solely among themselves or between all of them and a party who is not a shareholder, is not invalid, as among the parties thereto, on the ground that it so relates to the conduct of the affairs of the corporation as to interfere with the discretion of the Board of Directors, but the making of such an agreement shall impose upon the shareholders the liability for managerial acts that is imposed by the laws of this State upon directors.

Section 12. Management by Shareholders. (a) The articles of incorporation of a close corporation may provide that the business of the corporation shall be managed by the shareholders of the corporation rather than by a board of directors. So long as this provision continues in effect,

1. No meeting of shareholders need be called to elect directors;
2. Unless the context clearly requires otherwise the shareholders of the corporation shall be deemed to be directors for purposes of applying provisions of The Business Corporation Act; and
3. The shareholders of the corporation shall be subject to all liabilities of directors.

(b) Such a provision may be inserted in the articles of incorporation by amendment if all incorporators and subscribers or shareholders of record authorize such a provision. An amendment to the articles of incorporation to delete such provision shall be adopted by a vote of the holders of record of at least two-thirds of all the outstanding shares of each class of the corporation. If the articles of incorporation contain a provision authorized by this Section 12, the existence of such provision shall be noted conspicuously on the face or back of every certificate representing shares issued by the corporation.

Section 13. Shareholders' Option to Dissolve Corporation. (a) The articles of incorporation of any close corporation may include a provision granting to any shareholder, or to the holders of any specified number or percentage of shares of any class, an option to have the corporation dissolved at will or upon the occurrence of any specified event or contingency. Whenever any such option to dissolve is exercised, the shareholders exercising such option shall give written notice thereto to all other shareholders. After the expiration of 30 days following the sending of such notice, the dissolution of the corporation shall proceed as if the required number of shareholders having voting power had consented in writing to dissolution of the corporation.
(b) If the articles of incorporation as originally filed do not contain a provision authorized by subparagraph (a) of this Section 13, the articles of incorporation may be amended to include such provision if adopted by the affirmative vote of the holders of record of all the outstanding shares of each class of the corporation.

(c) Every share certificate representing shares issued by a close corporation whose articles of incorporation authorize dissolution as permitted by this Section 13 shall conspicuously note on the face or back thereof the existence of the provision. Unless noted conspicuously on the face or back of the share certificate, the provision shall be ineffective.

Section 14. Judicial Dissolution. (a) The Circuit Court of the County in which the registered office of the corporation is located may entertain a petition of any shareholder for involuntary dissolution of any close corporation and, at the hearing, may appoint a receiver or trustee of the corporation and order it dissolved when it is made to appear that

(1) the directors or shareholders of the corporation are deadlocked in the management of the corporate affairs and, in the case of directors, the shareholders are unable to break the deadlock, or that the shareholders are otherwise deadlocked; and

(2) any remedy, including arbitration, provided in any written agreement of the shareholders upon deadlock has failed to eliminate such deadlock; and

(3) there is such internal dissension among the shareholders of the corporation that the business and affairs can no longer be conducted in the best interests of the shareholders.

(b) Any one or more shareholders desiring to continue the business of a close corporation may avoid the dissolution of the corporation or the appointment of a trustee or receiver under this Section 14 by electing in a written instrument filed in the proceeding to purchase the shares of stock owned by the petitioner at a price equal to their fair value. If a shareholder or shareholders making such election are unable to reach an agreement with the petitioner as to the fair value of his shares within 30 days after the filing of such election, the court shall, upon said electing shareholders giving bond or other security in an amount fixed by the court, stay the proceeding and proceed to determine the fair value of such shares as of the close of the business on the day on which the petition for the dissolution was filed.