The New Maryland Close Corporation Law

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By WILLIAM G. HALL, JR.*

The new Maryland Close Corporation statute,¹ which became effective in June, 1967, represents one of the most significant steps toward special recognition and treatment of the close corporation yet taken by any state. Developed by the Commission on the Revision of the Corporation Laws of Maryland, the Close Corporation subtitle was among the changes to the corporation law recommended by the Commission to the General Assembly at its 1967 Session.² It is the purpose of this article to analyze in some detail the theoretical background and expected operation of the new subtitle as an aid to its understanding and interpretation.³

Generally, lawyers think of such a corporation as a small business, often as a partnership operating in corporate form. More specifically, they would probably consider it to be a corporation having such characteristics as a limited number of stockholders, relatively small capital and earnings, stockholders actively participating in the business, no established market for the corporation's stock, and a close personal relationship among the stockholders.⁴ At the threshold of any attempt to develop statutory regulation of the close corporation is the problem of producing a workable statutory description of it. The new Maryland law in effect defines the close corporation as one

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² This Commission, appointed by the Governor in 1965 in response to a Joint Resolution of the General Assembly of that year, was charged with the study and revision of the corporation law with particular attention to certain designated problems, one of which was the development of special treatment for the close or small corporation. For the complete statutory revision recommended by the Commission, see Commission on Revision of the Corp. Laws of Md., Final Report, (Dec. 15, 1966). Slight changes in the recommendations contained in this report were made prior to enactment.

³ The opinions expressed in this paper are solely those of its author and do not purport to represent the position or opinion of the Commission or its members.

⁴ For general consideration of the characteristics of the close corporation see F.H. O'Neal, CLOSE CORPORATIONS: LAW AND PRACTICE § 1.07 (1958); Kramer, Foreword to Symposium Issue on "The Close Corporation," 18 LAW & CONTEMP. PROB. 433 (1953); Winer, Proposing a New York "Close Corporation Law," 28 CORNELL L.Q. 313, 314 (1943).
in which the stock is subject to certain specified transfer restrictions and which has elected close corporation status by unanimous vote of its stockholders.

As an introduction to the new law and before entering upon a section by section analysis of the Subtitle, it will be helpful to summarize briefly the benefits and restrictions resulting from the election of close corporation status. Easily the most important of these benefits is the power to regulate the affairs of the corporation and the relationships of the stockholders directly by contractual agreement.\(^5\) In the vast majority of "incorporated partnerships," such matters as division of profits, the voice to be given each owner in corporate decisions, employment rights, etc., are the subject of negotiated agreement among the parties prior to incorporation. Often, however, the lawyer finds it difficult to fit these individualized agreements into the standard corporate pattern. In some instances the parties' objectives can be accomplished only by a skilled corporate specialist and then only by the use of complex and cumbersome devices. The stockholders' agreement obviates the need for such devices, making it possible for any lawyer capable of drawing a contractual agreement to accomplish his clients' ends simply and directly.

The provisions making judicial dissolution more readily available to the close corporation also represent a better accommodation of the law to the special needs and character of the small business. Finally, the new law eliminates or relaxes certain formalities and standard procedures which are unnecessary in the case of the small corporation. A close corporation is permitted under the statute, for example, to elect to operate with less than the usual minimum of three directors or to eliminate the board of directors altogether in favor of direct stockholder action. Unless specifically requested by a stockholder, the close corporation is relieved of the necessity of holding an annual stockholders' meeting, and in contrast to present provisions limiting stockholders' inspection of corporate books and records, stockholders of the close corporation are given access to all records.

These advantages of close corporation status are available to any corporation willing to accept a general restriction upon the transferability of its stock, a cost which is not unduly high in view of the fact that in virtually every case in which the special benefits are appropriate, sound corporate planning dictates the use of stock transfer restrictions and a stock purchase agreement. Upon an election of close corporation status the transfer of the corporation's stock is automatically restricted by the statute, the shares being transferable only if the proposed transfer is either (1) permitted under a stock purchase agreement embodied in a stockholders' agreement, or (2) unanimously approved by the stockholders at the time of the transfer. A stockholder wishing to make a transfer not covered by a stockholders' agreement and for which he cannot obtain stockholder consent is given the right to liquidate his invest-

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\(^5\) Although the general validity of stockholders' agreements was established by the decision in DeBoy v. Harris, 207 Md. 212, 113 A.2d 903 (1955), uncertainty as to the extent of validation has resulted in lawyers being reluctant to rely on such agreements to any great extent in planning small corporations.
ment by forcing either dissolution of the corporation or purchase of his interest by the remaining stockholders. The procedure under which this right is asserted is relatively simple. After a request for unanimous approval of a proposed transfer has been rejected, a stockholder may petition for a judicial order of dissolution. Other stockholders wishing to continue the business may block the dissolution by electing to purchase the petitioner's stock. If such election is made and the parties are unable to agree upon the purchase price to be paid for the stock, the purchasing stockholders may request the court to appoint appraisers to determine the purchase price in the same manner in which the value of stock is determined upon the assertion of the stockholder's appraisal right under Section 73.6 After approval of the price to be paid, the court is given considerable latitude in establishing appropriate conditions of sale, including the power to order payment of the purchase price in installments. This broad grant of authority is designed to enable the court to best and most fairly adjust the competing interests of the parties in light of the facts of each case. As a practical matter, most cases can be expected to be settled on an informal basis without resort to this procedure, the threat of court action providing a strong stimulus to informal settlement.

THE PROBLEM OF DEFINITION

Although special statutory treatment for the close corporation has been urged for a number of years,7 practical efforts in this direction have been largely stymied by the key problem of defining these corporations. It was the solution of this problem which opened the way for the substantial progress represented by the new Maryland statute.

Lawyers, of course, understand each other when they speak informally of a close corporation, having in mind the general characteristics enumerated earlier. But informal use of the term is one thing and drafting a workable statutory definition of it is quite a different matter. The New York Law Revision Commission, for example, considered the feasibility of a close corporation statute in 1947 but abandoned the project because it could produce no satisfactory definition.8

In 1955 North Carolina enacted the first statutory definition of a close corporation,9 providing that such a corporation is one in which the shares are not "generally traded in the markets maintained by

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6. MD. CODE ANN. art. 23, § 73 (1966 repl. vol.).
securities dealers or brokers.” This definition was subsequently adopted in the South Carolina, Florida, and New York statutory sections providing limited close corporation treatment. The difficulty with the “not generally traded” definition lies in its uncertainty. At times lawyers would, of course, find it difficult to advise clients as to whether there have been sufficient sales of stock to constitute general trading. But this difficulty is not insuperable. Much more serious is the fact that the loss of close corporation status due to sales of stock may result in the serious question being raised as to the continued validity of any outstanding stockholders’ agreement. The clear validation of the stockholders’ agreement is the most important contribution of a close corporation statute, and a threat to the validity of such agreements not only impairs their effectiveness, but seriously discourages their use. Consider for a moment the investor in a small corporation who has secured the agreement of the other parties that he is to be given a place on the board of directors, regardless of his voting power. His lawyer under normal corporation law could assure him of this agreement through cumulative voting or classification of the stock. Of course, rather cumbersome provisions would be necessary to protect these devices against change or circumvention, but the end result could be relied upon with reasonable confidence. It seems unlikely that a lawyer would be willing to substitute a stockholders’ agreement for one of these familiar arrangements if there were danger that such an agreement could be thrown into question by future trading in the stock. True, stock transfer restrictions could avoid this danger, but if such restrictions will always be a practical necessity, the approach of the new Maryland statute seems preferable. This approach accepts the practical need for stock transfer restrictions in the close corporation and makes that fact the crux of its definition. Once effective restrictions upon transfers of stock are imposed, general trading in the stock is impossible. Under the Maryland approach, stockholders’ agreements cannot be thrown into question since the statute invalidates improper transfers of stock rather than the close corporation status itself.

Definition of the close corporation in terms of a maximum number of stockholders was considered by the Commission as a possible alternative to the North Carolina approach. Theoretical objection has been

13. N.Y. BUS. CORP. LAW § 620(c) (McKinney Supp. 1967).
14. In view of § 104(e) and DeBoy v. Harris, 207 Md. 212, 113 A.2d 903 (1955), the loss of close corporation status might well be held to have no affect upon an outstanding stockholders’ agreement, but until further decisions amplify the DeBoy case the matter remains in doubt.
15. Such an approach has frequently been suggested. See, e.g., Bradley, Toward A More Perfect Close Corporation — The Need for More and Improved Legislation, 28 CORNELL L.Q. 313 (1943). This approach has recently been incorporated as one of the qualification requirements under the new Delaware close corporation statute. DEL. GEN. CORP. LAW § 342 (2 P-H CORPORATION 1967).
made to numerical definition on the ground that any number which is selected would be arbitrary and without genuine and substantial relationship to the purpose of the limitation.16 While this is true, more practical problems are involved. Here, even more than in the case of the "not generally traded" definition, there is serious danger of the validity of an outstanding stockholders' agreement being called into question, since, for any one of a variety of reasons, the number of stockholders may increase past the permitted maximum causing loss of close corporation status. Here, as there, the only practical protection is a comprehensive restriction upon the transferability of the stock. When such restriction is imposed by the statute itself, as under the new Maryland law, further requirements, such as a limit on the number of stockholders, become unnecessary. In addition to the problem of loss of close corporation status, definition in numerical terms creates the difficulty of determining who is to be counted as a stockholder. If the numerical limitation is to be applied to stockholders of record, are trusts, corporations, estates, and other representatives to be counted as a single stockholder? If so, the numerical limitation becomes almost meaningless because of the ease of circumvention. On the other hand, the disqualification of trusts, corporations, and other representatives as stockholders of the close corporation would seriously limit its usefulness.17 If, to avoid this dilemma, the numerical limit is applied to holders of beneficial interests, even more difficult questions arise. For example, would all beneficial interests be included, however remote or contingent? If not, which of these are to be counted? Unless transfers of interests in the stock were closely restricted, one could never be certain that a trust or other instrument creating future interests had not invalidated the qualification as a close corporation.

In spite of these problems, numerical definitions have been used in certain special contexts. Subchapter S of the Internal Revenue Code18 limits to ten the number of stockholders of a small business corporation, the stockholders of which may elect to be taxed upon corporate income substantially as individuals in lieu of the applicable corporate tax. The problem of who is to be counted as a stockholder is resolved by specifying that stockholders must be individuals. As pointed out, however, this could be done in the case of a close corporation statute only at the cost of seriously limiting its usefulness, a cost which seems unwarranted if there is an acceptable alternative. More importantly, the possible invalidation of a governing stockholders' agreement as a result

17. The close corporation has attractive possibilities for use by other corporations as a simplified method of operating a wholly owned subsidiary or as a vehicle for a joint venture to which the corporation will be a party. Although primary emphasis in close corporation reform is placed upon the usefulness of the device to the small businessman, other legitimate uses should not be ignored. The new Delaware close corporation law presumably excludes corporations and trusts having corporate trustees as stockholders of a close corporation by the use of the word "persons" in § 342(a)(1), while allowing trusts in which the trustees are individuals. Del. Gen. Corp. Law § 342(a)(1) (2 P-H Corporation 1967).
of the loss of close corporation status has, in most instances, much more serious implications than loss of the benefits of Subchapter S.19

The British and Puerto Rican corporation statutes furnish further examples of the use of a numerical limitation to define the small corporation for special purposes. The British private company, which is defined in part as a corporation having no more than fifty stockholders,20 is exempt from certain informational reporting required of corporations under the British equivalent of the Securities Exchange Act. The Puerto Rican statute provides that corporations having no more than eleven stockholders may elect to operate without a board of directors.21 In both of these statutes, as in the case of Subchapter S, the loss of the affirmative benefits of the statute is substantially less serious than possible invalidation of the stockholders' agreement.

In summary, the purpose of a statutory definition of a close corporation is not to set forth an accurate general definition of the term, but rather to differentiate between corporations for which the particular benefits being provided in the statute are appropriate and corporations for which those benefits are not appropriate.22 If feasible, it would have been desirable to extend the benefits of the new Subtitle to all corporations on the ground that the burden of formalities and restrictions imposed on businessmen should be reduced wherever possible. A consideration of each of the benefits established by the Subtitle will indicate that in every case the reason for not extending the benefit to certain corporations relates to the fact that the stock of those companies can be readily traded resulting in (1) purchase of stock by inactive stockholders who are vulnerable to abuses by insiders or active owners, or (2) purchase of stock under conditions which do not provide strong practical assurance that the purchaser will be made aware of the corporation's status as a close corporation and of any governing stockholders' agreement.23 Under the new Maryland statute, those corporations having stock transfer restrictions which effectively eliminate general trading of the stock may take advantage of the statutory benefits. Thus the ground of distinction between corporations for

19. Loss of such close corporation benefits as the right to operate without directors or the elimination of the requirement of a stockholders' annual meeting is more nearly analogous to the loss of Subchapter S benefits.

20. The British private company is a corporation which (1) limits to fifty its membership, (2) restricts the right to transfer shares and (3) prohibits invitation to the public to participate. Companies Act of 1948, 11 & 12 Geo. 6, c. 38, § 28.


22. "The close corporation is not a particular business form, but rather a generic name for corporations which should be exempted from certain corporate norms, and it should be defined in terms of the particular characteristic which justifies the exemption." Note, Statutory Assistance for Closely Held Corporations, 71 HARV. L. REV. 1498 (1958). The Note presents an interesting development of this general idea although differing from the Maryland statutory draftsmen in its ultimate conclusion. Any attempt to develop a close corporation statute involves the "chicken and egg" dilemma in that the way that a close corporation is defined depends upon the consequences which are to be attached to the definition, and the consequences which are attached to the definition depend on the way in which the term is defined.

23. In the case of validation of stockholders' agreements the statute expresses the limited decision that such validation is clearly appropriate in the case of a corporation electing statutory close corporation status. The question of the appropriateness of such agreements for other corporations is expressly left to future judicial determination under § 104(e).
which the benefits are appropriate and those for which they are not is closely tailored to the reasons underlying the need for the distinction. In addition, the danger that governing stockholders' agreements may be thrown into question is avoided since the statute invalidates prohibited transfers of stock rather than the close corporation status itself.

**The Statute**

**Election of Close Corporation Status — Section 100.**

Under the provisions of Section 100 close corporation status is acquired by placing in the charter of the corporation a statement that it is a close corporation, and such status continues so long as the statement remains in the charter. Both the inclusion of this statement in the charter and its removal require unanimous stockholder consent. Election of close corporation status is required to be unanimous because it results in a basic change in the nature of the corporation. The requirement that termination of the status also be unanimous is necessary to protect minority stockholders relying upon a stockholders' agreement to secure bargained-for rights. It does this by giving them a veto over an action which might call into question the continued validity of that agreement.

Clear reference to the fact that the corporation is a close corporation is required by Section 100(c) on stock certificates and at the head of all charter documents. The Subsection expressly states, however, that compliance with these requirements is not a prerequisite to acquisition of the close corporation status. Although the requirement of Section 100(c) may appear ineffectual in the absence of statutory sanctions for failure to comply with it, the alternative of making close corporation qualification turn upon the existence of reference to the status on stock certificates or the clarity of the charter reference would create a trap for the unwary with quite serious consequences. On balance, the risk of non-compliance seems the lesser evil.

**Restrictions on Transfer of Stock — Section 101.**

As has been pointed out, the new statute makes the election of close corporation status an automatic election to restrict transfer of

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24. The distinction should be noted between this provision requiring clarity of the charter reference and the requirements of § 100(a) that the charter state that the corporation is a close corporation. While close corporation qualification depends upon the existence in the charter of the § 100(a) statement, the clear-reference-at-the-head-of-the-charter requirement of § 100(c) is supplementary and non-compliance with it has no effect upon qualification as a close corporation. As a practical matter, of course, a charter document which does not comply with § 100(c) would not be accepted for filing by the Department if it is aware that the corporation is a close corporation.

25. Cf. L'Neal, *Developments in the Regulation of the Close Corporation*, 50 *Cornell L.Q.* 641, 657-58 (1965), where the same conclusion is reached in reference to an analogous requirement that provisions regulating the management of the corporation be contained in the charter or a similar document in order to be valid. Elsewhere in the Maryland Corporation Law sanction or penalty is omitted for failure to hold the organization meeting required by § 55 of Article 23 or the annual stockholders' meeting required by § 38(b) of the same Article.
the corporation's stock to transfers which are specified in a stockholders' agreement or those unanimously approved by the stockholders at the time of the transfer. These transfer restrictions are set forth in Section 101.

Section 101(a)(1) authorizes any transfer of stock which has been unanimously approved by the stockholders within three months prior to the transfer. This provision provides flexibility for the unforeseen situation and at the same time protection for all of the participants against an unwanted new "partner."

Section 101(a)(2) authorizes, in addition, any transfer which "is made pursuant to a provision of a stockholders' agreement authorized by Section 104 of this subtitle requiring the purchase of stock by, or the offer of stock to (i) the corporation, or (ii) one or more of its stockholders or its security holders, or (iii) one or more persons named in the agreement." It should be carefully noted that the phrase "requiring purchase of stock by, or the offer of stock to" apparently does not permit the stockholders' agreement to validate a transfer by will or inter vivos gift. It would seem also to exclude approval in the agreement of an offer to sell where there is neither a requirement that the offer be made nor that it be accepted. Since the purpose of Section 101(a)(2) is to provide maximum scope to the parties to tailor the agreement to their particular needs (consistent with insuring that the transfer restriction actually operate to exclude public trading), it would seem necessary that the provisions of this subsection be broadened to permit a much wider range of transfers.

While the agreement may authorize transfers to stockholders or security holders of the corporation without naming them, all other transferees must be expressly named. This latter requirement is designed to prevent the complete elimination of the transfer restriction through overly broad exemptions in the stockholders' agreement.

26. It is suggested that § 101(a)(2) should be amended to read "such transfer is made pursuant to a provision of a stockholders' agreement authorized by § 104 of this subtitle permitting transfer to (i) the corporation, or (ii) one or more of its stockholders, its security holders, or the wives, children or grandchildren of such stockholders or security holders or (iii) one or more persons named in such agreement" (changes in italics). In addition to the substitution of the words "permitting transfer to" for the words "requiring the purchase of stock by, or offer of stock to," the suggested amendment would add the words "the wives, children or grandchildren of such stockholders or security holders." This latter addition would permit more flexibility in estate planning since the wives, children or grandchildren of a stockholder or security holder could be designated without the necessity that they be specifically named. For example, it would allow the stockholders' agreement to approve a distribution among a stockholders' children living at his death, regardless of the fact that some of the children were born after the execution of the agreement. It would also be desirable to permit transfers in trust for the benefit of an approved transferee.

27. The word "persons" in § 101(a)(2)(iii) is intended to include all named persons or entities, including corporations, etc.

28. Such a result would seem possible under § 342 of the new Delaware close corporation statute: "[A]ll of the issued stock of all classes shall be subject to one or more of the restrictions on transfer permitted by section 202 of this title. . . ." § 202(e) provides that "Any other lawful restriction on transfer or registration of transfer of securities is permitted by this section." Del. Gen. Corp. Law § 342(a)(2) (2 P-H CORPORATION 1967).
while at the same time providing flexibility to the parties in drafting the agreement to carry out their special needs.

While it seems fair to say that the planning for virtually every close corporation should include a stock purchase agreement, it was necessary to recognize that such an agreement will sometimes be omitted and that the statute should provide a reasonably workable alternative for the corporation in which there is no agreement. Section 101 (b) sets out this alternative. The stockholder who is unable to make a transfer of stock due to the absence of authorization for the transfer in a stockholders' agreement and a refusal of unanimous permission for the transfer by the remaining stockholders is given the right to liquidate his investment by forcing either a dissolution of the corporation or purchase of his stock by the remaining stockholders. His right to force dissolution is set forth in Section 101 (b) which specifies that the dissolution is to be carried out under the procedure outlined in Section 109. That section establishes the right of stockholders wishing to continue the business to prevent dissolution by purchasing the stock of the person seeking the dissolution. As noted previously, it is likely that as a practical matter, most cases will be resolved by informally negotiated sales among stockholders rather than by resort to the formal procedure of Sections 101 (b) and 109.

This right of the close corporation stockholder to liquidate his investment through dissolution is to a limited extent a reversal of established corporate policy. The right of less than a two-thirds majority of stockholders to force dissolution has generally been narrowly restricted on the ground that the interests of those wishing to continue the business outweigh the interests of stockholders wishing to terminate it. For the publicly held corporation, this general approach is probably sound. In the great majority of cases involving such corporations the stockholder or group of stockholders desiring dissolution represents a relatively small proportion of the ownership. Where a market exists for the company's stock, dissolution is not necessary to allow the stockholder to liquidate his investment since he can do so by sale of his stock. These considerations, however, have little if any force in the case of the corporation which is essentially a partnership. As a practical matter there is seldom a market for the stock of such a corporation, the result being that a stockholder who is not employed in the business holds an investment that is all but worthless since he cannot liquidate it, dividends in such companies being relatively rare. When there are few stockholders as in the small corporation, the interest of each will represent a much greater percentage of ownership. Hereetofore,

the dissolution policy developed primarily in reference to the publicly held corporation has also been applied to the incorporated partnership since there was no practical method of designating the corporations for which the general rules were inappropriate. Since the new close corporation law provides a means for making this distinction, a reversal of the traditional policy is both appropriate and desirable in the case of the small corporation. It should be noted that the extent of this change is carefully limited. The right to dissolution comes into play only in cases where the transfer is neither provided for in the stockholders' agreement nor permitted by unanimous stockholder approval. In addition, the dissolution may be blocked by any stockholder willing to purchase the stock of the shareholder seeking termination. Finally, the stockholders are given the broad power to entirely eliminate the dissolution right in the stockholders' agreement if they consider it undesirable.

The statute might well have gone further and omitted the requirement of a request for, and denial of, stockholder approval of a proposed transfer as a prerequisite to the right of a stockholder to liquidate his investment. Such a change would, in effect, have been an adoption of the basic policy of partnership law that, absent contractual provisions to the contrary, each partner may liquidate his partnership interest at will. Not only would this have simplified the statutory scheme, but it would have offered a solution to the common and serious problem of the stockholder who is frozen into a close corporation because of the general absence of a market for the stock of such corporations and the consequent unavailability of the Section 101(b) remedy. Other states considering a close corporation approach similar to that of the new Maryland statute should give careful consideration to this alternative.

When the dissolution right is limited to cases in which approval of a transfer has been refused, it must be recognized that a stockholder desiring to withdraw his investment might well be able to circumvent the prerequisite with a little imagination. For example, such a stockholder might request approval of a transfer to his wife. If the approval is denied, he has his dissolution right. If it is given, he makes the transfer to her, then both request approval of a further transfer and each vetoes the other's request thereby setting up the dissolution right. Although this device is stated in bald terms for illustrative purposes, it would in practice be camouflaged as estate planning or other legitimate effort and spread over a period of time. As the dissolution petition must be addressed to an equity court, such circumvention would probably not be permitted on general equitable principles. However, it was considered advisable that it be made clear in the statute that the court should be alert for attempts to evade the statutory purpose and should deny the petition when such an attempt is found. It was, therefore, specified in Section 101 (b) that the proposed transfer must be "bona

fide.” It should be emphasized that the use of this term was directed at the danger of circumvention of the statutory purpose and is not intended to require a firm or even a tentative offer for the stock to have been made by a third person before a request for transfer may be properly made. The requirement of a firm offer as a prerequisite to a request for stockholder approval of a transfer was specifically considered by the Commission and rejected as too burdensome. In this same connection, the purpose of the requirement that the proposed transferees be named in the request for permission to transfer is simply to inform the remaining stockholders of the identity of any prospective “partner” in order that they may determine whether he is acceptable and does not indicate a necessity that an offer has actually been made.

It cannot be emphasized too strongly that the lawyer establishing a close corporation should not rely on the provisions of Section 101 as a substitute for a stock purchase agreement. The stock purchase agreement should be made a primary part of the planning for any corporation electing close corporation status under the new Subtitle, and in the drafting of this agreement, careful consideration should be given to the advisability of eliminating the Section 101 (b) right of dissolution altogether in favor of a comprehensive contractual scheme.

Although the statutory restriction applies generally to all transfers of stock, Section 101 (c) makes special provision for certain types of transfers. In the case of such legal representatives as executors, guardians, and trustees in bankruptcy, the effect of the subsection is simply to substitute them for the original stockholder. During the period such representative holds the stock, he may exercise voting and other rights as in the case of any other corporate stock.

In connection with a transfer or sale to a third party, even one contemplated by the nature of the office, such as transfer by an executor to a legatee, the representative is also treated as a stockholder. If he is unable to obtain unanimous consent to the transfer, his only recourse is to convert the shares into cash through enforcement of his right to dissolution. Although during the period of the administration of the estate of a deceased stockholder or during guardianship the other stockholders are forced to accept an unwanted “partner,” this is the most practical compromise of the interests of all of the parties in such situations.

The subsection does not specifically validate a retransfer by a guardian or conservator to his ward upon removal of the ward’s disability. However, the validity of such a transfer without the necessity

33. § 101(c) provides:
For purposes of this section, “Transfer” means all transfers of any interest in the stock of a close corporation other than (i) a transfer by operation of law to an executor, administrator, trustee in bankruptcy, receiver, guardian, conservator, or similar legal representative, (ii) the acquisition of a lien or power of sale pursuant to an attachment, levy or similar procedure, and (iii) the creation or assignment of a security interest. A foreclosure sale or other transfer by a person who acquired his interest or power in a transaction described in the foregoing clauses (i), (ii), and (iii) shall be a transfer subject to all the provisions of this section, and the person effecting such foreclosure sale or other transfer shall be treated as and have the rights of a holder of the stock under this section in connection with such transfer.
of stockholder permission would clearly fit the statutory scheme, and it is to be hoped that a court would so interpret the section. A transfer from an executor or guardian to a successor in office, on the other hand, would be valid as a "transfer by operation of law" to one of the enumerated representatives.

As in the case of the legal representative, the sheriff or other officer levying execution is placed in the position of a stockholder in carrying out the execution sale.\(^{34}\) Remaining stockholders are given the protection of the right to veto transfer to a successful bidder in which event the execution may be satisfied only through dissolution or stockholder purchase.\(^{35}\)

It was considered important to preserve to the greatest extent possible whatever value small corporation stock might have as security; consequently transfers of a security interest were expressly permitted. In satisfying his debt out of the stock he holds as security, however, the security holder is placed in the position of a stockholder and may only sell the stock or transfer it to himself with the unanimous permission of the other stockholders. If such permission cannot be obtained, he may force dissolution or purchase of the stock by the other stockholders.

### Issue or Sale of Stock by the Corporation — Section 102.

Section 102 places two limitations upon the issue or sale of stock by the corporation itself. The first is the requirement of stockholder approval of each sale, and the second is a prohibition against the use of certain hybrid securities.

The requirement in Subsection (a) of unanimous stockholder approval of any sale of stock by the corporation complements the restriction on transfer of stock as protection to existing stockholders against the introduction of new and unwanted "partners." In addition, it provides them with protection against changes in their proportionate interests in control, profits, and assets.\(^{36}\) This simple and easily understood provision was considered by the Commission to be preferable to a statutory pre-emptive right, which would necessarily be complicated and involve many uncertainties of interpretation. Although the approach of Section 102 (a) has the virtue of simplicity, it also has the serious drawback of giving each stockholder a veto over new financing

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34. Technically the power of sale vested in an attaching officer is not a transfer to him, but it was thought better to avoid possible controversy by expressly affirming its validity.

35. If the high bidder at an auction sale held by the sheriff is rejected by the other stockholders, it is highly doubtful that the sheriff will assert the dissolution right. It will probably be necessary for the appointment by the court of another representative to do so, such as a receiver appointed in Supplementary Proceedings under Md. R. Civ. P. 628.

36. Cf. O'Neal, Molding the Corporate Form to Particular Business Situations: Optional Charter Clauses, 10 Vand. L. Rev. 1, 41-42 (1956), in which the special importance of protection of the stockholders of the close corporation against new issues of stock is developed.
for the corporation through the sale of its stock. In view of this and because the only purpose of the provision is protection to the stockholders themselves, the section gives the stockholders power to remove this limitation by agreement. 37 The ultimate effect of Subsection (a), then, is to force the stockholders to consider this important area of their relationship by requiring them to take affirmative action to release the protection which the provision affords. It should be noted that an election to remove the requirement of stockholder approval would leave the issuance of stock of a close corporation subject to the same pre-emptive rights which are applicable to all corporations under Maryland common law as qualified by Section 30 of Article 23. 38 The lawyer in planning the close corporation must give careful consideration to both the election under Section 102 (a) and the pre-emptive right provisions of Section 30.

Subsection (b) of Section 102 prohibits the close corporation's use of "(i) any securities (including stock) which are convertible into its stock, (ii) any voting securities other than stock and (iii) any options, warrants or other rights to subscribe for or purchase any of its stock which are other than nontransferable." Such securities will seldom, if ever, be needed in the close corporation, and the possibility of their use would add substantially to the complexity of the new statute and to the difficulty of understanding it.

Unanimous Stockholder Vote — Section 103.

Section 103 (a) requires that all stockholders, whether or not having a vote on other matters, must join in any action required to be unanimous under the Close Corporation Subtitle. 39 The chief actions of this type are the elections to acquire and to relinquish close corporation status, approval of transfer of stock, and approval of the stockholders' agreement. All of these actions so fundamentally change the rights and relationships of the equity owners — the partners — that the veto power is a desirable protection. Section 103 is chiefly a housekeeping section, expressly stating what was considered to be implicit in the language of the various provisions to which it applies.

Stockholders' Agreements — Section 104.

The heart of the new Close Corporation Subtitle is its validation of the stockholders' agreement under Section 104. 40 The Maryland Court of Appeals gave strong indication of the validity of such agree-

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37. In contrast to the restriction on transfers of stock by stockholders, this provision is not crucial to the prevention of public trading and for this reason can appropriately be eliminated by stockholder agreement.
39. In some sections the vote of additional persons, such as subscribers for stock, is also required. E.g., § 100(a).
40. This section provides in part:
Section 104, Stockholders' Agreements — Close Corporations.
(a) The stockholders of a close corporation may, by an agreement to which all of the stockholders of the corporation have actually assented, regulate
ments and its willingness to enforce them in DeBoy v. Harris,\(^4\) decided in 1955. But, although there is every expectation that this case will be extended since it is sound and highly practical, there remains the uncertainty as to its ultimate reach which is inherent in any case enunciating new doctrine.\(^4\) In view of this uncertainty, lawyers have been reluctant to rely to any substantial extent on such agreements in planning the small corporation. Section 104 (a) gives clear and unqualified assurance that almost any aspect of the affairs of the close corporation or the relationships of its stockholders may be regulated by such agreements.\(^4\) The question of whether and to what extent stockholders' agreements should be validated by the courts in other contexts is expressly left open under Section 104 (e) which provides that "nothing in this section shall affect otherwise valid agreements among stockholders of a close or other corporation." This subsection makes it clear that a question of the validity of a stockholders' agreement in a corporation which has not elected close corporation status or among less than all of the stockholders of a close corporation is to be decided upon its merits and that no implication of invalidity should be drawn from the existence of the Close Corporation Subtitle and Section 104.

Underlying Subsection 104 (e) is the judgment that considerations any aspect of the affairs of the corporation or the relations of the stockholders, including but not limited to:

1. the management of the business and affairs of the corporation;
2. restrictions on the transfer of stock;
3. the right of one or more stockholders to dissolution of the corporation at will or upon the occurrence of a specified event or contingency;
4. the exercise or division of voting power;
5. the terms and conditions of the employment of any officer or employee regardless of the length of the period of such employment;
6. the persons who shall be directors and officers of the corporation; and
7. the payment of dividends or division of profits.


42. In the DeBoy case plaintiff and the two defendants had entered into an agreement characterized by the court as a joint venture agreement. This agreement was intended to regulate the parties' interests and internal relationships in connection with proposed construction and sale or leasing of warehouses. The agreement specified that a corporation would be formed to carry out the project, and that its stock would be issued in such amounts as to give each party the proportionate interest in profits, assets and control which had been agreed upon in the joint venture agreement. Three years after formation of the corporation the defendants sought to dilute the plaintiff's interest in the corporation (which by then had proved highly profitable) by the sale to one of them of additional stock. The court held that the agreement controlled the relationship of the parties as stockholders and fixed their respective interests in profits and assets so that these could not be changed by the defendants' action. The breadth of language used in the opinion and the rejection of Jackson v. Hooper, 76 N.J. Eq. 592 (1910), which had stood for many years as a leading case invalidating stockholders' agreements, gives every indication that the holding of DeBoy would be extended in future cases.

43. Compare the affirmative approval of the stockholders' agreement contained in § 104(a) to the negative approach taken in the North Carolina statute which provides that "... no written agreement to which all of the shareholders have actually assented ... 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 relationship in a manner that would be appropriate only between parties." N.C. Gen. Stat. §§ 55-73 (1955). Substantially the same approach is found in S.C. Code Ann. §§ 12-16.22 (1962).
pertinent to the extension of the DeBoy case and the validity of stockholders' agreements in these other contexts can be developed more effectively by the courts on a case by case basis than by statute. The importance of Section 104 (e) for the continued flexibility and growth of the law in this area cannot be over-emphasized.

The validation of the stockholders' agreement makes possible the tailoring of the corporate structure to fit exactly the needs and desires of the owners of the business. Recognition is thus given to a basic characteristic of the incorporated partnership — that the rights and interests of the parties are the highly individualized product of negotiation and agreement among the "partners" and seldom fit comfortably into the standard corporate pattern. Also implicit in the approval of contractual variation of the normal corporate procedures is the premise that these procedures are not an end in themselves and that the owners of the business should be allowed to regulate their affairs in any manner they see fit unless a good reason appears to the contrary.44 The areas of activity subject to regulation by the stockholders' agreement which are enumerated in Section 104 (a) are not exclusive, but are examples of the type of activity which may be regulated.

An important provision of Section 104 (a) is the express validation under Subsection (6) of the allocation of corporate offices and positions on the board of directors among the "partners" by stockholders' agreement. Such an allocation is often an integral part of the parties' basic bargain, especially when it represents a means of allocating control and distributing profits. An interesting question is raised as to whether a stockholder to whom a specific corporate office or a position on the board has been allocated by such an agreement may be removed without cause by vote of the other stockholders or directors under Sections 52 (d) and 61 of Article 23.45 It is suggested that to allow majority stockholders to welch on their bargain in this way would clearly run counter to the policy expressed in Section 104. Sections 52 (d) and 61 represent protection for the stockholders from abuses by a representative government. While this is sound in the case of the publicly held corporation, there is little necessity for it in the case

44. For a particularly persuasive statement of this position, see Latty, The Close Corporation and the New North Carolina Business Corporation Act, 34 N.C.L. Rev. 432-37 (1956); for other arguments in the same vein, see Bradley, Toward a More Perfect Close Corporation — The Need for More and Improved Legislation, 54 Geo. L.J. 1145, 1148-49 (1966); Hornstein, Stockholders' Agreements in the Closely Held Corporation, 59 Yale L.J. 1041 (1958). The internal procedures under which corporate decisions are made and the regulation of such internal matters as the relationships among stockholders have no substantial effect on the rights of third parties or their relationships to the corporation. Historically the board of directors was not an original or fundamental part of the corporate concept. In England there was no statutory requirement of a board of directors prior to the enactment of the Companies Act of 1929, 19 & 20 Geo. 5, c. 23, § 139. In addition, until the decision in Automatic Self-Cleaning Filter Syndicate Co. v. Cuninghame, [1906] 2 Ch. 34 (C.A.), the directors were generally considered simply the agents of the stockholders and completely subject to their control. See, e.g., Isle of Wight Ry. v. Tahourdin*, [1883] 25 Ch. D. 320 (C.A.). In the United States several of the early state business corporation statutes contained no requirement of a board of directors. E. M. Dodd, American Business Corporations Until 1860, 100 (1954).

of the close corporation, particularly when such protection would be achieved at the cost of undermining the integrity of a governing stockholders' agreement.

In expressly validating long-term employment contracts for officers under Section 104 (a) (5), the statute removes any doubts concerning the validity of such contracts which may linger at common law. Although the question of the power of the board of directors to make long-term employment contracts has not been raised in Maryland, a group of older cases in other jurisdictions have invalidated employment contracts of corporate officers on the grounds of excessive length or that the term of the employment exceeded the term of office of the board of directors.\(^4\) Because one of the most important benefits of investment in the small corporation is the right to employment in the business, it is crucial for the parties to be able to establish employment rights at the outset and to know that the bargain may be depended upon.

Section 104 (b) requires unanimous stockholder consent to any amendment of the stockholders' agreement and precludes provision in the agreement itself permitting amendment by less than unanimity. The purpose of this provision is to afford protection to the minority stockholder against any change in the agreement which he has negotiated and upon the basis of which he has invested. There is much to be said, however, for leaving the decision as to whether this protection is needed to the stockholders themselves by allowing the stockholders' agreement to specify amendment by less than unanimous action. Since the agreement itself must have unanimous approval, each stockholder would have the opportunity to consider the acceptability of such a provision at the outset and to veto it if he found it undesirable. The position adopted in the statute is based upon a fear of abuse especially in cases involving small businessmen who may not fully realize the implications of the provision to which they are consenting.

Section 104 (c) deals with the problem of persons acquiring stock subsequent to the execution of a stockholders' agreement. Such a stockholder is made a party to the agreement if he has actual knowledge of its existence at the time of acquiring his stock. The term "actual knowledge" is intended to preclude ascribing constructive notice of the agreement to the purchaser on the basis of reference to the agreement in the charter or on the stock certificate. Actual knowledge is not, however, required in the case of a stockholder acquiring his stock by a gift or bequest from a party to the agreement. As a party, the new stockholder is not only subject to the restrictions of the agreement, but may enforce its provisions against other stockholder-parties. In other words, he becomes a full "partner" under the "partnership agreement."\(^4\)

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\(^4\) Any prospective purchaser of stock in a close corporation in which there is an outstanding stockholders' agreement, should carefully review its provisions and, when
One of the most difficult problems in connection with the stockholders' agreement is the treatment to be accorded the purchaser of stock who has no knowledge of a prior stockholders' agreement. As a practical matter, the situation is likely to occur infrequently. Although small businesses are regularly bought and sold, such sales most often involve the entire business rather than the sale of a single "partner's" interest to an outsider. Because of the normal caution involved in buying into the small business operated essentially on a partnership basis, reasonably careful investigation by the purchaser can be expected in most cases. In addition, the stockholders who are remaining in the business and who must approve the transfer have strong incentive to insure that the newcomer knows of any provisions of a stockholders' agreement which will affect his relationship with them. When a lawyer is involved, it is highly unlikely that the existence of an agreement will not be ascertained and the parties made aware of it. Even where a purchase without knowledge occurs, failure to disclose such critical information as the existence of a stockholders' agreement would be likely to constitute fraud or misrepresentation sufficient to support an action for rescission of the sale if the seller is available and financially responsible, thereby providing a way out of the difficulty. In spite of these considerations, however, cases of this kind may occasionally arise. In such situations, the provisions of the agreement, while still enforceable by the parties against each other, would not be enforceable against the new stockholder. At the same time, the newcomer would have no right to enforce any of the provisions of the agreement without becoming party to it. Since this situation is unsatisfactory to everyone concerned, it places considerable pressure on the existing shareholders to make certain that prospective purchasers have knowledge of any existing stockholders' agreement and on purchasers to inquire as to the existence of an agreement.

Section 104 (d) provides that a stockholders' agreement may "be enforced by injunction or such other relief as the court may determine to be fair and appropriate in the circumstances." This provision establishes no power which an equity court does not already have. The express reference to the power of specific enforcement is included solely for the purpose of insuring that the courts entertain no doubts as to their broad powers under the new statute.

Section 104 (d) further provides that, "As an alternative to the granting of an injunction or other equitable relief, the court may, upon the motion of a party to the proceeding, order dissolution of the corporation under the provisions of Section 109 (b) and (c) of this

appropriate, negotiate a new agreement with the remaining stockholders before making the purchase, since purchase of the stock would be likely not to constitute purchase of the prior stockholders' contractual rights under the stockholders' agreement absent agreement to this effect by the other stockholders.

48. While this statement is true in the case of the close or other small corporation, it is clearly not applicable to the case of the corporation in which the stock is traded with any degree of frequency and in which there is no close personal relationship among the stockholders.

49. Under Maryland procedure, the term "injunction" includes court orders requiring affirmative action, as well as those prohibiting specified conduct. Md. R. Civ. P. BB70a.
Dissolution should be granted under this provision at the discretion of the court, when it appears that termination of the relationship will be in the best interests of all of the stockholders. The reasonably amicable personal relationship necessary in most cases to the success of a small business will almost invariably be destroyed when the parties have been through a court action, and dissolution may be the best solution from the standpoint of all parties, including the one who emerges the winner of the judicial proceeding. Strict enforcement of specific terms of the governing agreement may, due to rupture of the personal relations or to other changed circumstances, secure short-run advantage for the winner in the proceeding without providing him the real substance of his bargain.

Board of Directors — Sections 105 and 106.

Section 106 permits the owners of a close corporation to reduce the number of directors below the normal minimum of three, and Section 105 permits the elimination of the board of directors altogether. Election under one of these sections will be especially appropriate in situations in which all of the stockholders would also be directors or in which there are only one or two stockholders and dummy directors would normally be necessary. These sections are based upon the premise that representative government may be neither necessary nor useful in a corporation with few stockholders and that the decision as to whether this is true for the particular corporation is best left to its owners.

If elimination of the board of directors is elected under Section 105, all actions which would have been taken by director vote will be taken by the voting of shares in accordance with normal procedure for stockholder action, at a meeting or otherwise.

The provision of Section 105 (b) that the elimination of directors will become effective only after there has been an issuance of stock is cumbersome, but is required by the practical necessity of designating someone who can carry out the first stock issuance. Without it, the
elimination of the directors would leave no one available to issue the initial stock. The only alternative to the procedure specified in Section 105 (b) would have been to delegate this task to the incorporators or possibly to subscribers. Whichever alternative were utilized, some safeguards against improper or unfair conduct on the part of those issuing the stock would be necessary. Unlike incorporators who have no fiduciary position under Maryland law, or subscribers whose fiduciary position, if any, is uncertain, directors' fiduciary responsibilities are well established and understood. Utilization of this ready-made relationship was preferable to an attempt to create a wholly new set of fiduciary duties for this limited purpose.

Section 105 is careful not to specify that the common law fiduciary responsibilities of directors are to be shifted to stockholders when the election has been made to eliminate the board. There is good reason for this. The fiduciary responsibilities of directors were developed at common law as a protection for the owners of the corporation against the abuse of delegated power by persons acting in a representative capacity. The stockholders of a close corporation having no board of directors are not representatives acting for someone else, but rather are the owners of the business acting in their own interests in exactly the same manner in which the stockholders of other corporations are acting for themselves in voting upon any question to come before a stockholders' meeting. Although the fiduciary responsibilities of directors and officers are highly developed under present law, the fiduciary limits, if any, on the exercise of controlling power by stockholders are still in the embryonic stage. The relatively few cases which have dealt with this responsibility have provided little useful guidance as to how far it extends. It may well prove, of course, that the special nature of the relationship among stockholders operating a close corporation without directors dictates extension of the present fiduciary responsibilities of controlling stockholders in these situations. If so, this extension should come from the courts rather than the legislature, since the common law process is particularly well suited to the development of such fiduciary responsibilities. Section 105 omits any provision regarding the fiduciary position of stockholders when there are no directors in order to leave this question to the courts for development on a case by case basis.

54. On the question of limitation on sale of controlling shares, see Perlman v. Feldman, 219 F.2d 173 (2d Cir. 1955). The confusion which has been caused by this case is evidenced in the commentaries which followed it. See, e.g., Hill, The State of Controlling Shares, 70 Harv. L. Rev. 986 (1957); Jennings, Trading in Corporate Control, 44 Calif. L. Rev. 1 (1956); Leech, Transactions in Corporate Control, 104 U. Pa. L. Rev. 715 (1956). Other leading cases on various aspects of the fiduciary duties of stockholders to each other include Zahn v. Transamerica Corp., 162 F.2d 36 (3d Cir. 1947); Lebold v. Inland Steel Co., 125 F.2d 369 (7th Cir. 1941), cert. denied, 316 U.S. 675 (1942); Cheff v. Mathes, 41 Del. Ch. 494, 199 A.2d 548 (1964).

Section 105 (c)(1) imposes liability upon stockholders voting for illegal dividends, redemptions of stock and distribution of assets on liquidation, or for loans to officers of the corporation. The fact that these prohibitions are also imposed upon directors by Section 62 does not indicate a legislative intention that directors and stockholders should in other situations be treated in the same manner. The legislative determination is simply that in the enumerated situations the proscribed activity should be discouraged regardless of who is taking the action. The reference to Section 62 is a drafting convenience and has no significance as an indication of similarity between directors and stockholders for purposes of determining the fiduciary responsibilities of the stockholders to each other.

Annual Meeting of Stockholders — Section 107.

The present statutory requirement that an annual meeting of stockholders actually be held each year is eliminated for the close corporation by Section 107. This elimination of a requirement which is normally considered a stockholder safeguard is warranted by the close connection with the business and greater awareness of its affairs which is typical of stockholders of the close corporation. A sufficient safeguard is retained in that the section gives any stockholder the right to require in a particular year that the annual meeting be held at the time specified in the by-laws.

Inspection of Books and Records — Section 108.

Under Section 108, any stockholder of a close corporation is entitled to inspect and copy all books and records of the corporation. The limitations upon the right of inspection contained in Section 51 and similar provisions in the statutes of other states are appropriate as protective measures for the large corporation against harassment and unduly burdensome demands of stockholders, but for the corporation with few stockholders and relatively simple books such protection is unnecessary.

Judicial Dissolution Upon Petition of a Stockholder — Section 109.

Judicial dissolution at the discretion of the court is available to the stockholders of all corporations (including close corporations) when the conditions of Section 79A of Article 23 are met. Under Section

58. For a general discussion of the need for a broad right of inspection of corporate books and records in the close corporation, see O'Neal, Molding the Corporate Form to Particular Business Situations: Optional Charter Clauses, 10 Vand. L. Rev. 1, 40-41 (1956).
59. Md. Code Ann. art. 23, § 79A (1957), as amended, (Supp. 1967). This section is new, having been passed as a part of the general revision of the corporation law by the General Assembly in 1967; § 79A replaced § 52(e) of art. 23 which formerly controlled judicial dissolution and which was repealed as a part of the revision.
79A(a), holders of twenty-five percent of the voting stock of the corporation may petition for dissolution if action by the board of directors is impossible due to director deadlock or if election of directors is prevented by stockholder deadlock. Under Section 79A(b), the holder of any stock entitled to a vote upon the election of directors may petition for dissolution if the stockholders because of deadlock have failed to elect directors for two successive annual meeting dates or if there have been illegal, oppressive or fraudulent acts by the directors or "those in control of the corporation."

In addition to his rights under Section 79A, the stockholder of a close corporation is given the option of seeking dissolution under the broader provisions of Section 109. This section provides that dissolution may be ordered at the discretion of the court when "there is such internal dissension among the stockholders of the corporation that . . . business and affairs . . . can no longer be conducted to the advantage of the stockholders generally." Dissolution is made more readily available to the close corporation by Section 109 on the ground that the close personal relationship and lack of a market for the stock make dissolution an important safety valve for the stockholders of such corporations. The standard under which a Section 109 dissolution is to be granted is deliberately broad in order to allow the courts the widest possible latitude in reaching fair and sensible results in a wide variety of cases. The question of whether dissolution should be made available in a given case is essentially a question of balancing the interests of the parties and the equities in light of the facts of the particular situation. No attempt to lay down a detailed statutory formula describing the circumstances under which dissolution would be appropriate for a close corporation could hope to be successful. Of course, it should be borne in mind that certain considerations will recur in many of the cases. For example, it should be recognized that in almost every case some stockholders will suffer disproportionately in the event of liquidation. Relative fault in creating or prolonging discord would also seem an appropriate consideration. A court might well, for example, consider whether either side has made an offer to purchase the stock of the other, to sell its own stock, or has rejected an offer to buy or sell by the other side.

Of major importance under Section 109 is the newly established right of the stockholders of a close corporation wishing to continue the business to avoid dissolution by electing to purchase the interest of any stockholder petitioning for dissolution. This provision applies to any judicial dissolution of a close corporation whether pursuant to Sec-

60. This will often occur, for example, when there is an inactive partner who could not operate the business alone because of lack of training and experience, commitment of his time elsewhere, or for some other reason. See, e.g., In re Radom & Neidorff, Inc., 307 N.Y. 1, 119 N.E.2d 563 (1954).

61. The broad discretionary power granted the court by § 109 would also make available the technique of issuing a decree ordering dissolution to be effective on a specified date unless an offer had been made by a stockholder to purchase the petitioner's stock at a stated price prior to that date.

tion 109 or Section 79A. It results in a fair accommodation of the conflicting interests involved, on the one hand the desire to continue a profitable enterprise, and on the other, a desire to secure reasonable value for one's ownership interest.

It seems likely that in the great majority of cases a purchase of the interest of the liquidating stockholder will be negotiated among the interested parties on an informal basis. The formal procedure established by Section 109(c) and its cost serves as a practical pressure to produce informal negotiation as well as an alternative procedure should such negotiation break down. In the event that it becomes necessary for a determination of the value of the stock to be made by the court, the new section incorporates the already established procedure for determining the value of stock in the case of a stockholder's assertion of his appraisal remedy under Section 73. Under this procedure, a determination of the value of the stock is made by three court-appointed appraisers. The report of the appraisers is submitted to the court and to the parties, who may file objections to it and request a hearing if they desire. The court may then approve or modify the determination of the appraisers or reject it and order a new determination to be made. Section 109 (c) adds to the Section 73 procedure broad power in the court to direct the conditions of sale, including the power to order payment to be made in installments where appropriate. The provision for equal division of the costs of the appraisal proceeding between selling and purchasing stockholders is designed to place pressure on both sides to negotiate the sale out of court.

Stockholders asserting their right to bar dissolution by the purchase of the stock of a stockholder petitioning for dissolution are required to give bond or sufficient security to insure their ability to pay a reasonable price for the stock. This serves both as a protection to the stockholder seeking dissolution and as a deterrent to harassing or delaying tactics.

There is a danger that stockholders who in fact wish to continue to operate the business might permit dissolution and liquidation of the company in order to buy the assets at a lower figure than it would be necessary for them to pay if they elected to purchase the stock of the shareholder seeking dissolution. Since this would circumvent the statute's purpose of providing the stockholder a reasonable alternative when transfer of his stock is barred, it is to be hoped that the courts will not approve liquidation sales to other stockholders over the objection of the liquidating stockholder when such sales make it possible for the remaining stockholders to continue the business.

In the event a petition for dissolution has been filed and more than one of the remaining stockholders seeks to purchase the petitioner's stock, the statute expressly leaves the apportionment of the stock among the purchasing stockholders to the discretion of the court. In such a situation, disposition of the stock among the purchasers should generally be made in such a way as to leave the purchasing stockholders

as nearly as possible with the same interests and powers relative to each other as they had prior to the sale.

Unanimous Stockholder Approval of Mergers, etc. —
Section 110.

Section 110 provides:

In the case of any consolidation or merger of a close corporation or the sale, lease, exchange or other transfer of all or substantially all of its property and assets pursuant to the provisions of Section 66 of this Article, approval of the proposed articles under Section 66 (d) shall require the affirmative vote of the holders of all outstanding stock of the corporation.\(^6\)

This provision is designed to prevent the negation of close corporation status or an outstanding stockholders' agreement by the use of the device of a merger or sale of assets. It is also consistent with the general policy of requiring unanimity in the case of basic decisions affecting the close corporation.

AN APPRAISAL

For a good many years writers have strenuously urged special statutory treatment for the close corporation. In many instances the claims made as to the benefits to be derived from such statutes have been exaggerated. Brief reflection upon the new Maryland statute will indicate that it is by no means a panacea for all the ills of the small business. Its achievements are the simplification of somewhat burdensome formalities and the better adaptation of the corporate form to the needs of the "incorporated partnership." Lawyers and businessmen for years have lived with such requirements as a board of directors and an annual meeting and could continue to do so if necessary. True, many businessmen have probably fervently agreed with Mr. Bumble that "the law is a ass" when, as sole owners of a small corporation, they have been required to have a three-man board of directors, but they have survived the experience. On the other hand, the pruning away of unnecessary formalities is a constant necessity if the law is to be responsive to the needs of the business community and to maintain some vestige of respect from businessmen. Such other provisions as those making dissolution more readily available and those granting full stockholder access to corporate records represent a better accommodation of the interests of the parties under the special circumstances of the small business.

The most significant accomplishment of the new Subtitle, however, is the clear assurance which it gives to lawyers and their clients of the validity of the stockholders' agreement as a method of regulating the affairs of the small corporation and the relations of its stockholders.

\(^6\) Md. Code Ann. art. 23, § 66(d) (1966 repl. vol.), requires approval of the proposed articles of merger or of sale, lease, exchange or transfer by two-thirds stockholder vote in corporations other than a close corporation.
Under previous law, the corporate specialist could accomplish most client objectives, however demanding. This often required complex and cumbersome arrangements, but in the end the client's needs were satisfied. For this lawyer, the stockholders' agreement represents only a more simple and direct vehicle for accomplishing his ends. For the lawyer who is not a corporate expert, however, the stockholders' agreement may serve a more important function. Such lawyers are not usually versed in the highly sophisticated maneuvers needed to accomplish a client's special needs, and, for them, the direct contractual approach may be the means of achieving client objectives which would otherwise have to be abandoned. When it is remembered that most of the legal work for the small business is done not by the corporate expert, but by the general practitioner, this point takes on special significance.

As a less direct but nonetheless important benefit, it is to be hoped that the new statute will make both courts and lawyers more conscious of the significant differences between the publicly held and the "partnership" corporation and that this will be reflected in more responsive judicial decisions and more workable private arrangements.