Corporations: Majority Power and Shareholder Arrangements for Control

Robert A. Kessler*
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Abstract

The lot of the minority shareholder in a close corporation is not always happy

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ROBERT A. KESSLER*

The old story, so often told, of a prominent Eastern newspaperman's reply to the question of what the shares in his company were worth is very apt:

"There are 51 shares," said he, "that are worth $250,000. There are 49 shares that are not worth a ---."!

The lot of the minority shareholder in a close corporation is not always happy. Where the corporation utilizes simple form articles of incorporation containing only the mandatory provisions and the predominant contributor is given a majority of the voting shares, without restriction by any shareholder or voting trust agreement, the predominant contributor will have virtually total control. It is axiomatic that a majority elects the entire board no matter how many or few members it has. Thus, that majority controls all corporate decisions including the distribution or withholding of dividends, the election of all officers, and the hiring and firing of all other personnel. It is important that all participants in the corporate venture recognize, at its inception, the ramifications of this majority control.

Typically when a corporation is formed each of the participants desiring an active role will be given one. Thus, in a corporation of three equal shareholders each will frequently be given a directorship and an


2. The mandatory provisions are set forth in FLA. STAT. § 607.164(1). It should be noted that, as will be discussed below, majority power may also result from a coalition, even an informal or inadvertent coalition. For example, a husband and wife or two relatives together may hold a majority of the voting shares, although each technically has a minority interest; or, two equal shareholders may each sell or give an equal number of shares to a third person and whichever of the two the new shareholder sides with will then have majority power.
office. The lack of power of any one of the participants will not immediately be apparent. It will become so only when the real nature of majority power is understood. This lack of power of the minority becomes apparent when, as is typical, a dispute occurs in a corporation in which the minority has previously been allowed some participation in management.

As directors, the minority participants will have legal powers. However, the well established caselaw rule of directorial autonomy, in the face of majority shareholder dictation, is largely a myth. In fact, while direct interference in management may not be possible, a majority shareholder, albeit by more devious means, can generally achieve the absolute operating control theoretically denied him by the law.

**AN EXAMINATION OF MAJORITY POWER**

The following example illustrates the control that the majority shareholder might wield. Let us assume that a corporation has three shareholders, A, B, and C. A owns a majority of the corporation's shares, and B and C own the rest. Assume further that all three are represented on the board and split the offices of president, secretary, and treasurer. Obviously, this is a typical close corporation arrangement where the relations of the parties are amicable, initially.

If A wants the corporation to take a certain action such as entering into a long-term employment contract with A's son, D, this is a matter for the board of directors. A can obviously be outvoted by B and C, but can A, nonetheless, get his way? He could, of course, offer to buy B's and C's shares. Possibly overassessing their power and the value of their interest, B and C might try to blackmail A into a higher

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4. Fla. Stat. § 607.111(1) and Fla. Stat. § 607.107(2). Although Fla. Stat. § 607.111(1) technically only requires a provision in the articles to implement the exception to board power, no sensible attorney would insert such a provision without approval of at least all the initial participants.
price than their shares are realistically worth. In any event, the protracted negotiations might make this an undesirable solution.

An obvious means of getting his way is for A to wait until the annual shareholder meeting, and then vote in three directors of his own choice that are “friendly” to his plan. Barring a contrary shareholder agreement or high vote provision\(^6\) in the articles of incorporation, A can elect the entire board. Even if the corporation has cumulative voting,\(^6\) he can still elect two out of the three directors and thus get his way.\(^7\) This, of course, has the disadvantage, from A’s point of view, of having to wait till the next meeting. However, this wait may not be as long as one might assume since A may have the power to advance the date of that next meeting.\(^8\)

In addition to these two obvious methods of achieving his goal, A ordinarily will have available at least one of the following methods for guaranteeing that his demands will be met almost immediately: (1) removal of the directors who oppose him; (2) increasing the number of directors and “packing the board”; (3) decreasing the number of directors to get rid of the opposing members; (4) shortening the duration of

5. FLA. STAT. § 607.094(2). Assuming a quorum is present, the norm is that the affirmative vote of the majority of the shares represented at the meeting and entitled to vote shall constitute the act of the shareholders. However, the statute provides that a number greater than a majority may be required if the articles of incorporation or bylaws of the corporation so provide.

6. In cumulative voting each shareholder may take a number of votes equal to the number of shares owned times the number of directorships to be filled and cast all of them for one candidate or distribute them among several as he chooses. D.F. VAGTS, BASIC CORPORATION LAW, 825 (2nd ed. 1979).

7. Under the Williams formula for determining the effectiveness of cumulative voting (WILLIAMS, CUMULATIVE VOTING FOR DIRECTORS, 40-46 (1951)), one multiplies the number of shares represented at the meeting times the number of directors desired to be elected, divides by the number to be elected plus 1, and adds 1 to the result. This gives the number of shares needed to elect the desired number of directors. Under the formula, if 3 directors are to be elected, and A has 51% of the shares it becomes clear that he can elect 2 directors. See also LATTIN, CORPORATIONS 376 (2nd ed. 1971).

8. FLA. STAT. § 607.084(2) provides for an annual meeting of shareholders to elect directors “on such date and at such time as may be stated in, or fixed in accordance with the bylaws.” It also provides for a court-ordered election if the meeting is not held within any 13-month period. It does not, however, require that a full year elapse between annual meetings. A New York case held under a similar statutory provision that the date of the annual meeting could be advanced. Matter of Mansdorf v. Unexcelled, Inc., 28 A.D. 2d 44, 281 N.Y.S. 2d 173 (1967).
the corporation; or (5) increasing his power as an officer to enable him to do what he wants without director approval. In some jurisdictions he may even be able to abolish the board and retain management power to himself as a shareholder. The success of any of these methods is, of course, contingent upon A's power to call a special shareholders' meeting or approve the changes without one. This is, however, a power which he will frequently possess by virtue of his office or by virtue of statute. The mere threat of its utilization will normally be sufficient to coerce the opposition to give the majority shareholder his way. A further threat to the minority may be very effective. The majority shareholder may under the by laws have been given the power to remove non-consenting directors from their positions as officers. The votes of directors subject to such action may well be controlled by this threat to their compensation and status in other roles.

9. Florida may possibly be one of these. Fla. Stat. § 607.111(1) provides: All corporate powers shall be exercised by or under the authority of, and the business and affairs of a corporation shall be managed under the direction of, a board of directors, except as may be otherwise provided in this chapter or in the articles of incorporation. If any such provision is made in the articles of incorporation, the powers and duties conferred or imposed upon the board of directors by this chapter shall be exercised or performed to such extent and by such person or persons as shall be provided in the articles of incorporation. An amendment of the articles might be able to accomplish this, since this is a provision which could have originally been included (Fla. Stat. § 607.177(1)). Although the directors must usually authorize an amendment (Fla. Stat. § 607.181(1)(a)), the shareholders may enact such an amendment without such director approval, at a meeting for which notice of the changes is given (Fla. Stat. § 607.181(4)), by majority vote. Fla. Stat. § 607.181(1)(c). A majority shareholder, even though not an officer, has power to call a special meeting to adopt the amendment. Fla. Stat. § 607.084(3)(b). Although this conflicts with the spirit of Fla. Stat. § 607.107(2) which only authorizes director-infringing provisions where unanimous, it may be upheld, if Florida follows the Delaware "independent validity" doctrine. (Even though an action would be improper under one section of the statute, it is still permitted if it appears arguably proper under another.) This, of course, represents a rejection of the "pari materia" doctrine of statutory interpretation, and may not be followed in Florida.


11. Under Fla. Stat. § 607.151(1) the bylaws may provide for election of officers by the shareholders. If so, they may be removed by the shareholders. Fla. Stat. § 607.154(2). After removal of an officer, the vacancy thus created will, however, apparently be filled by the directors unless the power to fill such vacancies is also reserved to the shareholders. Fla. Stat. § 607.154(3).
Majority Power and Shareholder Arrangements

DEVICES FOR MAJORITY CONTROL

A number of the devices for majority control delineated above may be available in Florida. Some are not:

Removal of opposing directors.

Although removal of directors for cause is recognized at common law, removal without cause is generally not permitted. This represents the Florida common law rule; however, the current Florida statute, like Delaware's, provides: "At a meeting of shareholders called expressly for that purpose, directors may be removed in the manner provided in this section. Any director or the entire board of directors may be removed, with or without cause, by a vote of the holders of a majority of the shares then entitled to vote at an election of directors." Unless cumulative voting is provided for in the articles of incorporation or there are provisions in the articles for class directors, A can remove the uncooperative directors whenever he wants and fill the vacancies thus created with his own "puppets."

12. FLETHER, CYC. CORP. § 352 (Perm. Ed. 1975) [hereinafter cited FLETHER].
14. 8 DEL. CODE ANN. § 141(k).
15. FLA. STAT. § 607.117(1). It is not completely clear whether the requirement of Florida Statute section 607.117(1) for a meeting "called expressly for that purpose" was meant to override the provisions of Florida Statute section 607.394(1) which governs actions by shareholders without a meeting. If the latter section can be utilized A's task will be more simple.

Since A has the power to call a meeting (FLA. STAT. § 607.084(3)(b)), and, in the absence of special protective devices for the minority, his votes at the meeting will be sufficient to remove the offending directors, it would seem safer to go through the formality of holding such a meeting. See FLA. STAT. § 607.117(1). Removal without cause is still restricted in many states. Petition of Singer, 189 Misc. 150, 70 N.Y.S. 2d 550 (Sup. Ct. 1947); Abberger v. Kulp, 156 Misc. 210, 281 N.Y.S. 373 (Sup. Ct. 1935); Pilat v. Broach Systems, Inc., 108 N.J. Super. 88, 260 A. 2d 13 (Law Div. 1969); FLETHER §§ 352, 354.
16. FLA. STAT. § 607.097(4).
17. FLA. STAT. §§ 607.044(1), 607.164(1)(d).
18. See FLA. STAT. § 607.117(2), (3), for the limitations.
19. FLA. STAT. § 607.114(6).
Increasing the number of directors—"packing the board."

Florida statutes provide that the number of directors be fixed in the articles of incorporation, in the bylaws, or in a manner provided in those documents. Although power to amend bylaws is in the directors, "unless reserved to the shareholders by the articles of incorporation," the statute continues:

Bylaws adopted by the board of directors or by the shareholders may be repealed or changed, new bylaws may be adopted by the shareholders, and the shareholders may prescribe in any bylaw made by them that such bylaw shall not be altered, amended or repealed by the board of directors.

Although the statute is not completely clear that the shareholders have the right to increase the number of directors unless they have reserved all power over the bylaws or the number of directors has been fixed by the action of the directors, the language suggests that the grant of power to the directors was not intended to deprive the shareholders of their usual power over the bylaws. Accordingly, A should be able to succeed here as well. The result should be the same even if the number of directors is fixed in the articles of incorporation. A can, therefore, add two new directors to counter the votes of the two who oppose him.

However, unlike some other states, where the statute expressly gives permission to amend the bylaws to grant the power to the shareholders to fill such vacancies, or expressly provides that such vacancies will be filled by them, the Florida statute simply provides:

Any vacancy occurring in the board of directors, including any vacancy created by reason of an increase in the number of directors, may be filled by the affirmative vote of a majority of the remaining directors though less than a quorum of the board of directors. A director elected to fill a vacancy shall hold office only until the next election of directors.

20. FLA. STAT. § 607.114(1).
21. FLA. STAT. § 607.081.
22. Id.
23. See text at notes 32, 33 infra.
24. See N.Y. BUS. CORP. LAW § 705(a) (consol.) (McKinney’s CONSOL. LAWS OF N.Y.).
25. For example, N.J. STAT. ANN. 14A § 6-5(3) (1968).
by the shareholders. 26

No express exception for a contrary article or bylaw provision appears, and, accordingly, the shareholders may not have the power to fill such vacancies. Needless to say, if the directors fill them, A will be in a worse position than before. 27

Decreasing the number of directors.

A might try to reduce the number of directors to one, that is, himself. Again, in some states this device might succeed. 28 However, the Florida statute expressly provides:

The board of directors of a corporation shall consist of one or more members. The number of directors shall be fixed by, or in the manner provided in, the articles of incorporation. The number of directors may be increased or decreased from time to time by amendment to, or in the manner provided in, the articles of incorporation or the bylaws, but no decrease shall have the effect of shortening the term of any incumbent director. 29

While this method will not accomplish A's purpose immediately, he may use it as a means of giving himself complete control in the future, by fixing the number of directors at one.

Shortening the corporation's duration.

The practical effect of dissolution can be achieved by amending the articles of incorporation to set as the corporation's duration a date about to expire. Florida statutes expressly allow an amendment "to

26. FLA. STAT. § 607.114(6).
27. If the shareholders do have the power to fill the vacancies despite lack of express statutory authority, it is clear that A has the power to call a shareholder meeting to do so because he owns over one tenth of the shares. (FLA. STAT. § 607.084(3)(b)) In fact, it would appear that A will be able to act even without a meeting by virtue of Florida Statute section 607.394(1).
28. See N.J. STAT. ANN. 14A § 6-5(1) (1968) which does not contain the express restriction contained in FLA. STAT. § 607.114(1). See text at note 29.
29. FLA. STAT. § 607.114(1).
change the [corporation's] period of duration." In some states all amendments of the articles of incorporation require prior board approval. In such jurisdictions this solution would be unavailable to A. However, under Florida law "[t]he shareholders may amend the articles of incorporation without an act of the directors at a meeting for which notice of the changes to be made is given." Since A, as a majority holder has the power to call the necessary shareholder meeting, this method should succeed. Thus, the corporation's duration can be fixed in the articles for a term about to expire immediately.

Increasing officer power.

If, as discussed above, A as a shareholder possesses the right to amend the bylaws, he can increase his powers as an officer. The Florida statute provide that "[a]ll officers . . . shall have such authority and perform such duties in the management of the corporation as may be provided by the bylaws." A bylaw amendment providing for election of officers by the shareholders is also desirable since this will protect A from removal by the board. If A is president of the corporation he has the power, by virtue of his office, to enter into a number of transactions, although possibly not the long-term employment contract hypothesized. A may also have broad express powers if conferred on him by the bylaws.

Whether or not shareholders still retain the power to enact bylaws, still in the absence of a provision in the articles reserving the right, A will have the power, as discussed above, to amend the articles to reserve that power to himself as a shareholder. He can then amend the

34. Fla. Stat. § 607.151(2).
36. Fletcher § 566.
37. Fla. Stat. § 607.151(2). "All officers and agents, as between themselves and the corporation, shall have such authority and perform such duties in the management of the corporation as may be provided in the bylaws or as may be determined by resolution of the board of directors not inconsistent with the bylaws."
bylaws to broaden his powers as president. It could be argued that such expansion of officer power is an improper interference with board powers. The counter-arguments which should succeed, provided the amended bylaws do not attempt to supersede board management, are that all powers granted to officers are to some extent an encroachment on board powers and that the statute expressly validates the grant. This device will not prevent the board from later firing A’s son if B and C are allowed to remain members. However, if the president has the power to enter into the contract, this may be possible only on pain of the corporation’s paying damages. Even if B and C escape liability for causing the corporation to breach the contract, they may be discouraged from repudiating the contract since doing so will mean an injury to them through diminution in the value of their interest in the corporation.

Although sterilization of the board is permitted in Florida, the shareholder unanimity requirement for such action may make it unavailable to A as a practical matter. However, even in Florida, A appears to have more than one device available to him, and only one is necessary.

There is very little caselaw in Florida on the availability of these control devices as a means for a majority shareholder to get his way. If the corporation operates under Florida law, this uncertainty may well work to A’s advantage. The threat of their use, coupled with B’s and C’s knowledge that A will ultimately win, at least at the next annual meeting, will probably be effective to persuade them to accede to A’s demands.

Obviously, where the initial articles and bylaws are drawn up with provisions favoring the majority holder the success of coercive methods can probably be assured. For example, the articles of incorporation may expressly reserve all power over the bylaws to the shareholders or they may attempt to allow a majority shareholder to fill newly created board vacancies. Majority shareholder control can also prevent any change in the articles or bylaws seeking to delete these preferential pro-

39. FLA. STAT. § 607.107(2).

Except in [certain] cases . . . , no written agreement to which all 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 restrict the discretion of the board of directors in its management of the business of the corporation . . .
visions. If the initial bylaws provide for election of all officers by the shareholders, the majority shareholder can guarantee his election as president and his continued status as such. Presumably, the board will not even have power to suspend him. Even if it does, this can be countered by removal of the offending members. The initial bylaws can also provide for broad presidential powers.

The deceptively innocuous appearance of many of these provisions should be noted. An uninitiated minority shareholder might not realize that the effect is to place him almost completely at the mercy of any shareholder owning a mere 51% of the voting shares. Some provisions are so facially unfavorable that even an unsophisticated minority participant could hardly allow their insertion in the corporate documents unless he was content to be voiceless. It is not inconceivable, however, that a careless investor might buy into such a corporation without knowledge of a limit on the number of directors.

Even if the provisions guaranteeing majority absolutism are not included in the initial articles of incorporation and bylaws, all except the sterilization provision (which apparently requires unanimous vote for insertion by way of amendment to the articles) can be added after any annual meeting at which directors favorable to their addition are elected. This could be accomplished even where use of such power is to be held in abeyance until a conflict between the majority and minority participants actually develops.

LIMITING MAJORITY SHAREHOLDER CONTROL

A number of cases throughout the country recognize a fiduciary duty on the part of the majority shareholder to the minority shareholders. In flagrant cases of unfairness judicial intervention may limit a majority shareholder's absolute control over the corporation where he attempts to destroy fundamental minority rights. As to ordinary management, however, there is little that the minority can actually do to stop the majority. True, a derivative action for waste can be brought

42. Fla. Stat. §§ 607.114(1), 607.107(2), 607.111(1). At least where A is not the sole initial shareholder.
44. Fletcher § 5811.
against an improvident contract.\textsuperscript{45} (For example, the contract hiring A's son may amount to a kind of gift of the corporate assets.) The minority can also bring an action based on majority oppression.\textsuperscript{46} The derivative action for waste is sure to result in a pyrrhic victory since it will not prevent reprisals by A when he immediately, or ultimately, gains complete board control. His board can cut off all dividends, and unless B and C are protected by employment contracts, they may be ousted from officer and employee status. The second alternative, an action for oppression, is almost equally sure to be futile to the minority. Even if allowed, it is likely to result in their complete ouster from the business because dissolution will probably not produce an overly generous financial return. It is clear, therefore, that one way or another, majority voting share ownership means virtually absolute control over corporate management notwithstanding any contrary legal rules.

Obviously, majority power need not repose in the hands of a single shareholder. In fact, except in a corporation with only a sole shareholder, or two equal shareholders, there will always be a majority and a minority. Thus, in a three-person corporation in which each shareholder owns an equal number of shares, any two together can wield the autocratic powers described above. Where on particular decisions allegiances shift, with two voting one way and a different two voting together on another matter, the threat to the one who happens to be in the minority at any particular time may not be too great. This shifting of positions is probably what is envisioned by the participants when they fail to enter into a unanimous shareholder agreement governing their relations and omit minority-protective devices in the articles of incorporation and bylaws.

During the era of goodwill when the corporation is first formed, the assumption that unbiased decisions will be made in the best interest of all concerned may prove true. However, if over a period of time any two combine regularly to form a bloc, the power of the coalition and its consequent danger to the omitted member is obvious whether or not the arrangement is formalized.

\textsuperscript{45} \textit{FLA. STAT.} § 607.147.

\textsuperscript{46} Although not expressly authorized, as in some states (see, e.g., \textit{N.J. STAT. ANN.} 14A § (12)(7)(c)), some jurisdictions have recognized a non-statutory right to seek dissolution on this ground. (See Gaines v. Adler, 15 A.D. 2d 743, 223 N.Y.S. 2d 1011 (1962)).
Shareholder agreements are a means of consolidating power in a corporation. Much like the formation of a political coalition, such agreements may allow a combination of minorities to, in effect, control the affairs of a corporation where the individual power of the participants, when combined under the agreement, constitutes a majority voting bloc. The effect of such agreements, therefore, may be the same as where a single shareholder owns a majority of the corporation's shares. Such agreements are expressly valid in Florida and therefore clearly enforceable. However, all shareholders who are not parties are permanently relegated to a virtually powerless minority status.

THE LAWYER'S OBLIGATION

In setting up a corporation with more than a single shareholder, the attorney must exercise special care. It is axiomatic that an attorney cannot represent conflicting interests without full disclosure and the consent of all parties. Where more than one person comes to an attorney to set up a corporate business it would seem clearly improper, if the attorney purports to act for the two or more parties involved, to set up a typical corporate structure which allows majority control without explaining the implications of such majority power to all involved. The utilization of any of the additional provisions discussed above which help to further solidify such control or enable two or more minority participants to convert themselves, through an agreement, into a controlling majority would seem to require further explanation and knowing acceptance of the potential dangers by all involved. Nor should an attorney, purporting to act for all, set up a corporation and then draw up a shareholder agreement among less than all of the people for whom he formed that corporation without the knowledge and consent of the excluded participants.

A majority shareholder agreement can properly be regarded as an attack on minority interests because it consolidates almost absolute power against them. The agreement in the famous Ringling case is typ-

47. Fla. Stat. § 607.107(1).
ical. It was obviously directed against one of the shareholders of the corporation. In that leading Delaware case there were three shareholders; one owned 370 of the outstanding 1000 shares, while each of the other two held 315 shares. Since the corporation had cumulative voting, the agreement between the two smaller participants, had it been carried out, would have given the two minority shareholders not only control on the shareholder level, but five out of the seven director slots, thereby securing overwhelming management control as well. In a corporation with ordinary (straight) voting they would have elected the entire board! The combined effect was a guarantee of continued, if not excessive, financial participation in the venture.

Obviously, this arrangement will not be considered desirable by an excluded shareholder who will naturally fear a “freeze-out.” The result will be acrimony, if not actual litigation. Accordingly, the lawyer who drafts such an agreement should not be the one who has set up the corporation nor should he have previously represented the individual against whom such an agreement is directed.

ARRANGEMENTS FOR MAJORITY CONTROL

As indicated above, majority shareholder dominance can be achieved by a single majority shareholder’s control over the basic corporate structure at the formation of the corporation. Thus, such a shareholder can insist on the articles of incorporation providing for a single director. As sole director he will then have complete control. He may even be able to “lock in” the other shareholders by imposing restrictions on transfers of shares. Even if he transfers shares he can probably insist that the transferee give him an irrevocable proxy. Certainly he can insist that the transferred shares be placed in a voting trust of which the majority shareholder is trustee, although this may result in undesirable estate tax consequences to the majority share-

50. “In straight voting each share carries one vote for each matter, including one vote for each director to be elected.” H. HENN, LAW OF CORPORATIONS 363 (2nd ed. 1970).
51. FLA. STAT. § 607.101(5)(e).
52. FLA. STAT. § 607.104.
holder transferor.\footnote{IRC § 2036 as amended by the Revenue Act of 1978, § 702(i).}

Where, as in the *Ringling* situation, the exercise of majority power depends on a combination of shareholders, the voting trust or irrevocable proxy device can also be used. However, an agreement such as the one involved in the *Ringling* case is still probably the best model. That agreement wisely includes share transfer restrictions to attempt to assure that if one of the parties desires to sell his shares the other has the opportunity to maintain the previous control power. The significant parts of that agreement are as follows:

1. Neither party will sell any shares of stock or any voting trust certificates in either of said corporations to any other person whatsoever, without first making a written offer to the other party hereto of all of the shares or voting trust certificates proposed to be sold, for the same price and upon the same terms and conditions as in such proposed sale, and allowing each other party a time of not less than 180 days from the date of such written offer within which to accept same.

2. In exercising any voting rights to which either party may be entitled by virtue of ownership of stock or voting trust certificates held by them in either of said corporation, (sic) each party will consult and confer with the other and the parties will act jointly in exercising such voting rights in accordance with such agreement as they may reach with respect to any matter calling for the exercise of such voting rights.

3. In the event the parties fail to agree with respect to any matter covered by paragraph 2 above, the question in disagreement shall be submitted for arbitration to Karl D. Loos, of Washington, D.C. as arbitrator and his decision thereon shall be binding upon the parties hereto. Such arbitration shall be exercised to the end of assuring for the respective corporations good management and such participation therein by the members of the Ringling family as the experience, capacity, and ability of each may warrant. The parties may at any time by written agreement designate any other individual to act as arbitrator in lieu of said Loos.

4. Each of the parties hereto will enter into and execute such voting trust agreement or agreements and such other instruments as from time to time they deem advisable and as they may be advised by counsel are appropriate to effectuate the purposes and objects of this agreement.

5. This agreement shall be in effect from the date hereof and shall continue in effect for a period of ten years unless sooner terminated by
mutual agreement in writing by the parties hereto.

6. The agreement of April 1934 is hereby terminated.

7. This agreement shall be binding upon and inure to the benefit of the heirs, executors, administrators and assigns of the parties hereto respectively.\textsuperscript{54}

In addition to the sort of provisions provided above there would seem to be no objection to the parties' agreeing to vote for themselves as directors by name. Agreements with such provisions were held valid even under the restrictive New York common law.\textsuperscript{55}

The share transfer restrictions could perhaps even be strengthened. A first refusal provision as in the \textit{Ringling} case, or a first option provision, might be coupled with a provision that transfer to a non-party shall not be made without the consent of all parties to the agreement except where the transferee agrees to become a party to the agreement and bound by its terms.\textsuperscript{56} On the other hand, a provision whereby the parties agree to cause the corporation to repurchase their shares, or impose a corporate first option for their benefit, may be invalid as an attempt to control the directors, and, if not all shareholders are given equal treatment, may result in a charge of corporate waste if effectuated.\textsuperscript{57}

The provision such as is found in the \textit{Ringling} case for consultation, joint voting, and arbitration when the parties are unable to agree on how to cast their votes would seem to be valid under Florida Statutes section 607.107(1) which provides:

An agreement between two or more shareholders, if in writing and signed by the parties thereto, may provide that, in exercising any voting

\textsuperscript{54} 49 A. 2d 603, 605 (1946), \textit{aff'd.} 53 A. 2d 441, 443 (1947).
\textsuperscript{55} Manson v. Curtis, 223 N.Y. 313, 119 N.E. 559 (1918).
\textsuperscript{56} Although \textsc{Fla. Stat.} § 607.164(2) only expressly authorizes the articles of incorporation to contain share transfer restrictions an agreement should at least be binding on the parties. A legend should appear on the share certificates to make the restrictions binding on transferees without knowledge. \textsc{Fla. Stat.} § 607.067(3). While the corporation could be obligated to place the required legend on the shares an agreement to cause it to do so might be held to bind the parties in their directorial capacities. Accordingly, they may have to assume the onus of insuring the proper legend themselves.
rights, the shares held by them shall be voted as therein provided, as they may agree, or as determined in accordance with a procedure agreed upon by them. Nothing herein shall impair the right of the corporation to treat the shareholders of record as entitled to vote the shares standing in their names.

This would seem to be true because of the express statutory approval of non-unanimous agreements despite the anti-minority nature of such agreements.

Ballantine, writing in 1946, stated:

No doubt all agreements as to voting by a shareholder should be held contrary to public policy if the tendency of the bargain is to induce the voter to consider, in a decision affecting the rights of others, not the advantage of the corporation but the obtaining of advantages to himself or some other person, such as securing employment as an officer or as a manager for a salary. 58

Ballentine's statement of the law would seem to be repudiated by the above statute. 59 Certainly the agreement should avoid reciting as consideration such items as securing employment or officer status. Where the agreement clearly indicates that the other party's vote is being bought by a promise of favors from the corporation, the agreement will be hard pressed to withstand attack. But where the agreement demonstrates a result in mutual benefits to all parties through their enhanced control position it will likely survive.

A reference to voting on shareholder matters "in accordance with a procedure agreed upon by them" 60 would also seem to be a clear validation of the arbitration provision when the parties are unable to agree themselves on how their shares should be voted.

It would also seem possible to have the parties expressly agree to give the arbitrator an irrevocable proxy to vote the unwilling party's shares to implement his decision. The Chancellor in the Ringling case held that that was the effect of the agreement. However, he was overruled on that point by the Delaware Supreme Court which, although upholding the validity of the agreement, merely held that the non-con-

60. Id.
senting shareholder's shares could not be voted. The Delaware statute was subsequently amended to authorize an irrevocable proxy where it was coupled with an interest. Professor Ernest Folk, Rapporteur for the committee which drafted the Delaware amendments, commenting on that provision, stated:

Irrevocable Proxy: The revised statute has a new provision specifically recognizing the proxy as irrevocable if the instrument so states and the requisite interest is present. An interest in the stock or generally in the corporation will suffice. This should be sufficient to validate an irrevocable proxy held by a creditor during the term of the loan, or by a key officer during his employment contract period, or by a shareholder as an ancillary feature of a voting agreement.61

The Florida Statute section 607.101(5) is clear on this point: "A proxy which states that it is irrevocable is irrevocable when it is held by any of the following or a nominee of any of the following: . . . [and] (e) A person designated by or under an agreement under subsection 607.107(1)."62 Accordingly it would seem possible to provide expressly that the arbitrator has an irrevocable proxy to vote the non-consenting shareholder's shares in accordance with the arbitrator's decision. Cases in a number of jurisdictions have allowed enforcement of such agreements without any irrevocable proxy, using specific performance or mandatory injunction as the remedy.63 The grant of an irrevocable proxy with an express consent by the parties to enforcement of the agreement by equitable remedies might be wise.

While, as in the Ringling agreement, the promise to vote in accordance with its terms is prima facie valid as to matters where the parties are voting in their capacity as shareholders, any attempt to bind them in their director capacities may be invalid and could possibly void the whole agreement. Unless the bylaws already allow election of officers by the shareholders, a clause whereby the parties agree to elect themselves as officers, normally a director function, may be invalid. It would seem permissible, however, for the parites to agree to enact such a bylaw whereby they may elect themselves as officers. Further, it may well be improper for them to agree to vote for dissolution when they

62. See text at note 47 supra.
decide that such is desirable. A prior director vote is required for such action.\textsuperscript{64}

Provisions in the agreement as to declaration of dividends, hiring of non-officer personnel, or any provision under which the parties directly bind themselves on how they will vote on matters confided to the board may well be proscribed. The reason for this limitation is the general rule that agreements by less than all shareholders as to how they will vote as directors are invalid. The leading case is, of course, \textit{McQuade v. Stoneham}.\textsuperscript{65} In that New York decision a majority shareholder agreement to keep a named person as an officer at a specified salary was held invalid since it improperly interfered with the parties' discretion as directors. At the time, election of officers was an exclusively directorial function. Such election could not be confided in the shareholders as is presently possible by a bylaw provision in Florida.\textsuperscript{66}

There was Florida authority supporting the rule that "director-agreements" were invalid.\textsuperscript{67} The adoption of Florida Statute section 607.107(2) (1975), which expressly validates such interference with the board's normal prerogatives only where an agreement authorized by all the shareholders permits it, is an implied acceptance of the rule.

It is unlikely that such a director-sterilizing or board abolition provision will be included in the articles of a corporation where a majority-control agreement will be utilized. If the original participants are unwise enough to include it without assurance that they will be protected under it, the parties to the majority-control agreement may, however, be able to take advantage of the provision by binding themselves to vote on matters normally confided to the directors as well.

"Indirect" control over the board can be achieved by an agreement to vote to remove any directors whenever the holders of a certain percentage of the shares covered by the agreement demand it. Although the vacancies thus created may have to be filled by the board,\textsuperscript{68} this should enable the parties to the agreement to insure that the directors they have elected under the agreement remain loyal to their wishes.

\textsuperscript{64} \textsc{Fla. Stat.} § 607.257.
\textsuperscript{65} \textit{McQuade v. Stoneham} et al., 263 N.Y. 323, 189 N.E. 234 (1934).
\textsuperscript{66} \textsc{Fla. Stat.} § 607.151(1).
\textsuperscript{68} \textsc{Fla. Stat.} § 607.114(6).
since their people will constitute the remaining board members. Needless to say, this will produce the same alienation on the part of the ousted party to the agreement as is felt by minority non-parties.

**DANGERS TO THE ARRANGEMENT**

As indicated above, an agreement to consolidate and secure majority power is probably valid despite the obvious personal benefits to its parties provided: (1) it does not appear that the vote of a party is being bought, and (2) that it does not purport to bind the parties in their voting as directors. Both of these possible grounds of invalidity can probably be guarded against by proper drafting. For example, the consideration clause and recitals should be drafted in terms of the mutual benefit of the parties and the corporation. Provisions directly impinging on director functions can simply be avoided. Since the law is not completely certain as to what matters are the exclusive province of the directors a severability clause should also be used. Such a clause may save the balance of an agreement containing provisions later held to be improperly director-impinging.

As is also indicated above, if the effect of action taken under the agreement results in serious injury to minority interests, the transaction may be upset on the ground of breach of the majority’s fiduciary duty to the minority. This result, like liability for corporate waste or breach of duty to the corporation by the directors elected under the agreement, is independent of the validity of the agreement and a danger which the majority and its elected directors always face.

The greatest dangers to the arrangement will probably result from a disagreement among the parties or from the acrimonious relations vis-a-vis the non-parties to the agreement which they will quite reasonably regard as directed against them. It is impossible to specify in advance exactly how the shareholder parties will vote on all of the issues submitted to them. There are bound to be disagreements as to specific questions as they arise. The result will be that the arbitrator will make the ultimate decision. If too many decisions must be submitted to him the agreement may become unworkable. Also, since the parties, once they are elected directors, will be autonomous in that capacity, they will...

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69. *For example,* dissolution or alteration of shareholder rights.

70. As indicated above, text at note 68, provision can be made for their removal
control of the corporation's management will only be effective as long as the parties continue to agree. There can therefore be no guarantee that the agreement will fully achieve its ends.

Factionalization is always dangerous to the successful operation of a business. The excluded minority, the non-parties, may well be victimized by the majority or at least feel that they are. Needless to say, this will hardly inspire them to do their best for the venture. They may resort to litigation. Whether or not such litigation is successful it is bound to disrupt the business and, if continued, may cause its failure. It is this potential for built-in acrimony which is the principal objection to a majority agreement. A unanimous shareholder agreement, executed prior to incorporation, will, on the other hand, fix the rights and powers of all the participants in a manner freely consented to by all of them.

ADVICE TO PERSONS ACQUIRING A MINORITY INTEREST IN A CLOSE CORPORATION

Professor O'Neal gives a number of examples of minority shareholder oppression. A poignant one is that of a trusted employee who is rewarded by his bosses who allow him to buy an interest in the corporation. Understandably, the employee feels flattered at being taken into the business, but as an employee he is reluctant to press the bosses too much about the internal affairs of the corporation. Only too late will he discover what it really means to be a minority shareholder. The majority "bosses" have him almost completely at their mercy. He may be paid no dividends on his stock, and if he objects he may even lose his employment with the corporation. In effect, his investment may be completely lost to him since more sophisticated investors will be unwilling to buy his shares, especially when they know that they carry no return and give no power to compel it. The "favored" employee is in an especially difficult position since if he does not accept the majority's offer he may jeopardize his employment.

The ordinary prospective purchaser of a minority interest may not

from management positions. The ensuing acrimony will, however, probably lead ultimately to disruption of the management plan.

71. F. O'NEAL, OPPRESSION OF MINORITY SHAREHOLDERS § 3.02 (1975).
72. Id., at 41.
be so unfortunate. He can more freely demand greater information about the power dispersal in the corporation. Obviously, if the articles of incorporation disclose provisions which will help to solidify majority power the prospective purchaser should be especially cautious.

The best advice is not to buy a minority interest in a close corporation which allows absolute majority rule. This, of course, is the same advice that would be given to an initial participant in a newly formed close corporation. The desirability of a unanimous shareholder agreement with implementing articles and bylaw provisions agreed to by all parties must be emphasized. Where the original corporate setup does not provide for adequate protection to minority interests the minority investor should insist upon their adoption.

The extent of power conceded to the minority will, of course, depend on the relative bargaining positions. In Florida the minority can be given virtually absolute power through a provision in the articles of incorporation if all shareholders agree. The equivalent of majority shareholder control can be conferred on the minority through a carefully drafted voting trust agreement in which the minority shareholder is made trustee and given broad discretion, and the majority shareholders deposit their shares in the trust. Although the trustee will be subject to fiduciary duties to the majority, the practical effect is to give him the majority power discussed above. The trustee minority shareholder could also be given an irrevocable proxy to vote the shares of the other parties to the agreement. Unless the new minority holder is indispensable, however the majority will not make such drastic concessions.

Where the majority is unwilling to capitulate, the power of the minority can nonetheless be augmented to a greater or lesser degree, depending on the bargain struck. In consideration of the minority's investment, the majority can enter into an agreement including a promise to amend the articles and bylaws where necessary: (1) To fix the numbers of directors at a number large enough to include a slot for the minority; (2) to elect the minority shareholder, and as many of his

76. Fla. Stat. § 607.114(1).
designees as his bargaining position demands; to grant him a veto over all or selected fundamental shareholder decisions through a high vote requirement; if he is not given a majority of the board, at least to give him a veto power through a high vote requirement for all or selected director decisions. These are the same provisions which are advisable in a unanimous shareholder agreement in order to protect the minority (or potential minority) when any close corporation is formed.

Where all of the present participants agree, other devices to further protect the minority shareholder’s interest may be added, such as, cumulative voting, or a recapitalization where shares are made a separate class entitled to elect a specified number of directors, or by reclassifying some majority shares into non-voting shares to further magnify the power of the voting shares.

IN SUMMARY

The archetypal corporate structure gives great potential for majority imposition on the non-majority shareholder in a multi-shareholder close corporation. This potential can be taken advantage of by an agreement which coalesces a group of minority shareholders into an effective majority.

Because an agreement by less than all of the initial shareholders is bound to produce acrimony, it is inadvisable to proceed in such a fashion at the corporation’s inception. To do so poses dangers for the drafting attorney who purports to act for all parties and to any corporate structure seeking to facilitate the agreement. Any shareholder buying into a close corporation which makes possible majority domination

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77. Valid under Fla. Stat. § 607.107(1).
81. Fla. Stat. § 607.177(2)(f), (i), (j).
82. Fla. Stat. §§ 607.164(1)(e), 607.097(1), 607.117(3). This class voting for directors is not to be confused with “classification” or staggered terms, authorized by Fla. Stat. § 607.114(4), which may used to lengthen the terms of some directors, but is frequently not desirable in a close corporation because of the complexity involved, and discriminatory treatment of directors whose terms expire earlier.
83. Fla. Stat. §§ 607.044(1), 607.177(1), (2)(f), (i), (j).
should insist on changes in the basic corporate documents as protection from the minority oppression such a majority-oriented structure permits.

The best approach is an initial arrangement encompassed in a unanimous shareholder pre-incorporation agreement which promises inclusion of the necessary protective provisions for all shareholders in the original articles of incorporation and bylaws.