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The Model Act and the South Carolina Corporation Law

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THE MODEL ACT AND THE SOUTH CAROLINA CORPORATION LAW*

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I. INTRODUCTION

The South Carolina Business Corporation Act of 1962 was unanimously passed by the General Assembly and a few days later was signed into law by the Governor on March 30, 1962. This new statute represents a completely new look in corporation law for South Carolina. The prior law was no more than a collection of *ad hoc* provisions, enacted by the General Assembly as the need arose from time to time over a period of 150 years, and given the semblance of a corporate law only by their arrangement in the usual corporate law sequence. As a consequence, the prior law suffered from a remarkable combination of gaps, ambiguities, uncertainties, redundancies, and archaic restrictions with little or no bearing on contemporary problems.

Like virtually all recent corporate law revisions, the South Carolina law is largely patterned after the Model Business Corporation Act developed by the Committee on Corporation Law of the Section of Corporation, Banking and Business Law of the American Bar Association.[1] The new South Carolina law, however, contains some distinctive and noteworthy variations from the Model Act, although most of these are by way of adding provisions not found in the Model Act. The new statute, as a whole and in its details, recognizes what seemed to the South Carolina revisers to be the true function of the Model Act: that is, to serve, not as a uniform law

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1. For the sake of brevity, sections of the South Carolina Business Corporation Act of 1962 are cited simply as, *e.g.*, "S. C. §6.21." (Occasional citations to the prior South Carolina law are to the Code of Laws, *e.g.*, "S. C. CODE §12-311.") The American Bar Association Model Business Corporation Act is cited as, *e.g.*, "MODEL ACT §31"; the text in the annotated version is taken as definitive.

to be adopted in identical or near identical form in all jurisdictions, but rather as a framework for a streamlined corporation law, sufficiently flexible to accommodate widely differing state policies toward corporate enterprise without at the same time sacrificing some measure of corporate law similarity.

This article, then, undertakes to examine a selected group of significant and distinctive provisions of the new South Carolina statute against the background of the old law and the Model Act. It does not attempt to deal with every feature, or to justify each point at which the balance was struck between the competing interests involved in any corporation statute. Although the article is primarily expository, it does compare many of the South Carolina provisions with Model Act sections where there is contrast, and indicates some considerations prompting the choice of provisions not paralleled in the Model Act. It is also worth noting that most of these non-Model Act provisions have counterparts in other states, including some of those jurisdictions which have recently carried through the most searching analysis and study prior to enacting their new statutes. Indeed, the South Carolina law is, in large measure, a product of the knowledge and experience accumulating in successive state corporation law revisions. To ignore these developments and to adopt verbatim or nearly verbatim any one statute would be deliberately to isolate a corporate law revision from much of the best thinking in this field.

II. CORPORATE LAW REVISION IN A SMALL STATE: THE SOUTH CAROLINA EXPERIENCE

A. *The Revision Process: From Inception to Enactment.*

Before examining specific provisions of the South Carolina statute, it is helpful to retrace the steps leading from the determination to revise the corporation law to its final enactment, and to note some of the problems and decisions confronting the revisors. This is especially useful because the South Carolina experience is undoubtedly typical of many states confronted with the need to revise their corporate laws. Thus, unlike the comprehensive research and drafting techniques used in the New York corporate law revision, South Carolina had neither the resources nor the need for

such an undertaking, nor did it face baffling and complex problems confronting New York or any other large commercial state with many pronounced and divergent interests. Like many states only recently emerging from a rural to an industrial economy, South Carolina did not have a heavy burden of prior decisions to contend with. Apart from the old corporation statute and some special constitutional problems, it had a relatively clean slate on which to write. All of these factors shaped, in some measure, one final result.

The new South Carolina corporate statute had its inception in 1960 when the General Assembly created a joint committee, consisting of members of both houses together with appointees of the Governor and the Secretary of State *ex officio,* to consider revising both the Securities and the Corporation Law.[2] The first objective was achieved when the 1961 General Assembly enacted the Uniform Securities Law. In this field uniformity with Federal and other state laws was recognized as the overriding consideration in order to facilitate multi-state offerings of securities.

The preparation of a new corporate statute was approached from a different angle. One of the first decisions was also one of the most natural ones: the recognition that no existing corporation law could be adopted without modification. For example, although the Delaware law affords incomparable opportunities to corporate enterprise as well as an unusual degree of certainty because of the many Delaware decisions construing the law, the committee rejected a proposal, at an early point, to copy the Delaware Act. Apart from the fact that the Delaware law is not perfect—indeed, many Delaware corporate law decisions result from ambiguities or uncertainties in the law at the time of the decision—the committee decided it would not be in the public interest to grant special, perhaps unwise, favors merely to attract incorporation in this State. On the other hand, statutes primarily emphasizing the fiduciary duties of directors, officer, and insider shareholders, such as North Carolina and California, could not be imported wholesale into South Carolina. Although the Committee at one time considered recommending

2. During the period of the Corporation Law Revision project, the members of the Joint Committee were Senators Henry B. Richardson (Chairman) and Walter J. Bristow; Representatives Wallace D. Connor and C. Claymon Grimes; Secretary of State O. Frank Thornton; and Henry C. Nelson, Jr., Esquire, and Richard M. Osbourne, Esquire, appointed by Governor Hollings.

enactment of the Model Act without alteration, this proposal met strong opposition, since it would not best serve the interests of a corporate law revision. The initial decision, then, was to employ the Model Act as the framework for the new South Carolina law, but to modify it, wherever necessary, to include provisions which would best serve South Carolina's needs. This decision entailed a thorough and comprehensive study to determine in what respects the Model Act paradigm should be departed from. For these reasons, the Joint Committee decided not to hasten the drafting of a new corporate law, but to take time to study the problems, and prepare a draft law. In this respect, obviously, the problem of preparing a new corporation law was of a very different order from that of recommending the enactment of a Uniform Securities Act.

In late 1960 and early 1961, the Joint Committee completed its plan for the drafting of a new corporation law. First of all, it secured the invaluable support and interest of the Judicial Council of South Carolina, chaired by the Chief Justice of the State, and consisting of a number of prominent members of the bench and bar.[3] In addition, the Joint Committee cooperated closely with the Corporation Law Committee of the South Carolina Bar Association,[4] whose vigorous support was an important factor in securing enactment of the new law. At the same time, the committee established contacts with the Committee on Corporate Laws of the ABA's Section of Corporation, Banking and Business Law, and their experience and views were sought and relied upon.

The working arrangements for drafting the new law were completed when the writer was appointed as Reporter for the Corporation Law Revision project, with his responsibilities running both to the Joint Committee and to the Judicial Council of South Carolina. Working almost continuously through the summer, autumn, and winter of 1961, the Reporter concentrated upon research, study, and drafting of the new statute. In carrying forward his task, the Reporter, first of all, started with the Model Act section dealing with

3. The Judicial Council's Corporation Law Committee consisted of Senator L. Marion Gressette, Dean Robert McC. Figg, Jr., and David W. Robinson, Esquire.

4. The Bar Association Committee, chaired by Marshall T. Mays, Esquire, included Miss Jean Galloway, John Dillard, Esquire; Frank B. Gary, Esquire; and Thomas H. Pope, Esquire; with the able assistance of Charles W. Knowlton, Esquire.

a given point, and thereafter referred, *on every provision of the draft law,* to the treatment of that problem in a number of states. The states selected were California and North Carolina ("strict" jurisdictions), Connecticut and Ohio ("middle of the road"), New York (the then latest corporation law revision and one of the best), Delaware (the classic "liberal" jurisdiction), and Virginia (chiefly Model Act). In addition, on specific problems, the statutes of many other states and of England and some Commonwealth countries were constantly consulted.

Secondly, following the research and preparation of an initial draft of a proposed section, together with more or less extensive notes explaining the draft section, the Reporter followed the practice of sending these materials to a selected group with whom he maintained constant contact. The sections so distributed were grouped around the traditional topics of a corporation code: *e.g.,* directors, shareholders, dividends, etc., and were distributed in this form to the consultants. They included the members of the Joint Committee, the Judicial Council, and the South Carolina Bar Association Committee on Corporate Law. The comments and views of all were invited, and their criticisms and suggestions were, whenever received, carefully evaluated and often incorporated into the draft version of the new law.

Thirdly, the South Carolina revisers were especially fortunate in having the opportunity for lengthy consultation with members of the Committee on Corporate Laws of the ABA Section, at a meeting in New York late in October 1961. This meeting involved a frank and full exchange of views on corporation law generally, and a searching criticism and analysis of the then drafted provisions of the South Carolina law. Although there were points of unresolved disagreement, nonetheless the discussion was perhaps the most helpful which the South Carolina revisers had during the long process of drafting the new law.

Finally, late in 1961, when the initial draft of the new law had been completed, the mimeographed sections were collected and printed in a 268 page document which set forth the statutory text and the Reporter's Notes on each of the sections of the draft law. This printed version was widely circulated both in and out of South Carolina, and prompted a variety of suggestions and recommendations for the bill which was

to be introduced into the Legislature when it convened in January, 1962. Indeed one purpose served by the printed draft version was to draw the fire of critics and others before introducing the statute into the Legislature, and thereby speed the bill through the General Assembly, as was in fact the case.

After the printed draft had been circulated, the Bar Association sponsored two institutes on the new corporation law, held at the University of South Carolina Law School. The institutes were the occasions for long sessions of hard work by prominent and experienced corporation law attorneys. Each attorney was assigned in advance to a chapter of the new statute and given responsibility for evaluation and criticism of the provisions contained in the statute. Since criticism was the objective, there was obviously no effort to select attorneys who would be favorable to any or all of the provisions of the corporation law. The result of these discussions were a variety of penetrating suggestions, many of which were then incorporated in the final draft of the act to be introduced into the Legislature.[5]

The new statute, sponsored by the Joint Committee and recommended for adoption by the Judicial Council with the backing of the Executive Committee of the Bar Association, was unanimously passed by the Senate, and then by the House of Representatives with only three technical amendments from the floor.[6] On March 30, 1962, the enrolled bill was signed by the Governor.

B. *Guidelines in Drafting the New Law.*

Any major law revision, and in particular a corporation law, represents a judgment on balancing a number of factors.

5. A number of the participants in the Institute have contributed articles to this Symposium issue. In the order in which their articles appear, they are William H. Blackwell, Esquire; Charles W. Knowlton, Esquire; Julian J. Nexsen, Esquire; David L. Freeman, Esquire; Thomas K. Johnstone, Jr., Esquire; and Augustine T. Smythe, Jr., Esquire.

6. Three amendments to the Corporation Law were proposed from the floor of the House of Representatives; and were adopted: (1) The specific provision in Section 8.17(b) that any loan to directors or officers carry the going rate of interest and adequate security; (2) The provision in Section 6.27(k) permitting a derivative suit to survive although the plaintiff shareholder has dissented to corporate action and applied for payment of his shares; and (3) The requirement in Section 10.3(b) (3) that shareholders who are asked to approve a merger or consolidation be furnished balance sheets and profit and loss statements for the preceding three years.

The judgment may be explicit and based upon careful consideration of these various factors and the weight to be attached to them; or it may be implicit, emerging only after the work has been completed and therefore rationalizing a result. In drafting a corporation law, the more obvious factors include the need to assure corporate management maximum flexibility in operating the enterprise, protection of the rights of shareholders, and the distinctive needs of the close corporation. As is inevitably the case when a judgment must be made on balancing many competing considerations, each worthy of attention, there is a wide range of possible balances which might be struck.

Revision of the South Carolina law was greatly aided by five basic guidelines which were consciously and explicitly formulated early in the research and drafting process. These guidelines largely overlap; alone they afford no ground of choice when competing considerations are in conflict; and therefore they leave a wide area of choice. The experience of the South Carolina revisors, however, was that they did what they were supposed to do: that is, to call attention to the major considerations in drafting an up-to-date statute fairly adjusting the interests involved in corporate enterprise. By gauging each statutory provision, and the statute as a whole, against these considerations, it was possible to obtain a perspective on the new law. Each of these guidelines is discussed briefly.

(1) The necessity of securing for all corporations the maximum flexibility in corporate action, consistent with the rights of shareholders. For the public issue corporation, this meant that management should have as much freedom as possible in handling the problems of a business which may be nationwide or even worldwide in scope. In the case of the close corporation, this guideline dictated special provisions which would permit the corporation and its shareholders, who are normally its directors and officers, to act almost as freely as if they were in partnership with respect to the internal affairs of a corporation. In both instances, this objective is embodied in statutory declarations of a rule of law which prevails unless modified, or negated by a provision, which the new law permits to appear in the articles of incorporation, or occasionally in the by-laws. In consequence, the new statute is replete, to a degree greater than most present

corporate law revisions, with permissive provisions. The result is to give the businessman, whether large or small, and his attorneys, the opportunity to fashion the corporate enterprise which, in his judgment, best fits his needs.

(2) A second guideline was to make the Business Corporation Act, as far as possible, self-contained. Although the new law does not purport to be a code in the sense that it covers every possible corporate situation, with the objective of making unnecessary recourse to case law, nonetheless it seeks to solve in advance and directly from the statutory text as many corporate law problems as possible among those which might arise. It was, of course, recognized, as it must necessarily be, that even the most complete code cannot be wholly self-explanatory. This approach was also in part shaped by South Carolina's experience with its prior corporation law which was chiefly deficient because of gaps, ambiguities and uncertainties. Among the provisions which especially reflect this objective of self-containment are the sections governing proxies, including irrevocable proxies, shareholder voting and management agreements, and a section setting forth canons of construction for preferred shares.

(3) A third basic guideline was to provide for the needs of the closely held corporation. In this respect the South Carolina law follows the trend of recent corporation laws, beginning with North Carolina's 1955 statutory provisions governing closely held corporations, and developed especially in Connecticut and New York. Some consideration was given to the possibility of drafting a separate statute for the closely held corporation, but the revisors rejected the considerable effort of defining the closely-held corporation so as to distinguish it from corporations subject only to the general corporation law. Although such a definition has been used for several sections of the South Carolina law,[7] it is one thing to formulate a definition for such limited use, and quite another matter to devise a definition determinative of the application of the provisions of one or another statute. In all events, the South Carolina law gives particular attention to the close corporation, on the theory that here, as in other states, the small corporation is now and will long continue

7. Two provisions are specifically limited to close corporations, *viz.* Sections 6.22(b) (agreements permitting shareholders directly to manage corporate affairs) and 12.14 (agreements giving certain shareholders an option to have the corporation dissolved).

to be the most prevalent type of corporate enterprise in this State. More specifically, the new statute explicitly recognizes that most small corporations are no more than incorporated partnerships, that is, enterprises in which the shareholder-operators are partners *inter se* with limited liability vis-a-vis third persons.

(4) The new corporation law makes careful provision for the protection of shareholders and especially minority, preferred, and non-voting shareholders, thus carrying forward the traditional South Carolina solicitude for shareholder interests. Indeed, ignoring this would have been fatal to any corporation law revision in this State. In line with this objective, and also with the desire for self-containment and completeness, the new statute has, for example, codified the duty of directors and officers, and has also specified a special standard for those cases, especially frequent in the small corporation, involving transactions between corporate insiders and their corporation.[8] The proxy provisions already mentioned are similarly designed to protect shareholders at that point where his interests are most likely to be compromised. In this connection, a special problem was presented by the local constitutional requirement of cumulative voting. Although the draft version of the new law would have made cumulative voting permissive rather than mandatory,[9] opposition was so vigorous that cumulative voting was left mandatory, but with special provisions that clarify the indefinite contours of the cumulative voting right[10] as expressed in the old law.

(5) Finally, it should never be forgotten that, after all, a corporation law is largely designed to facilitate local business and to protect local shareholder and other interests. A corollary to this, and one of the assumptions upon which the South Carolina corporation law revision proceeded was that the new statute should not be used as a business-solicitation device. Although loose standards would undoubtedly attract some marginal enterprises into the State, the price would be too great to pay. Hence, the revisers refused, to paraphrase Judge Learned Hand's famous phrase, to be haunted by the ghost of the corporation excluded or fleeing the jurisdiction, recognizing that such fears are often unreal dreams. Nor

8. S. C. §§8.15, 8.16.
9. DRAFT VERSION, S. C. BUS. CORP. ACT §6.20 (Supp. 1962).
10. S. C. §6.20(b).

would it have been realistic to suppose that, even with a loosely drawn statute, enterprises would have likely changed their state of incorporation. For example, the attractions of Delaware and other traditional corporate domiciles lie not only in the freedom of corporate management, but also in such less tangible considerations as the certainty of the law, the quality of the courts which enforce the law, and the receptiveness of the legislature to new ideas. Thus, excessive and unwisely granted privileges would not attract corporations from an established domicile. Rather, were South Carolina to strain after such an objective, the effect might be to import enterprises expecting, under the cloak of "management discretion," to engage in practices oppressive to shareholders and detrimental to the public. Shunning that attraction, which must always stand as a lure to any corporate law revisers, the new statute took as its objective the simple one of preparing a law which would have maximum utility and value to legitimate business wishing to domesticate and operate in the State. Happily the law which achieves this objective is also the law which is most attractive to sound business.

III. ORGANIZING THE CORPORATION

Whatever the need for complexity or detail in other branches of corporation law, there is no justification for burdening the incorporation process with useless formalities and other requirements productive of delay, inconvenience, or worse. It is indeed a reproach to early corporation laws that they should have set up conditions in the incorporation process which so frequently resulted in the embarrassment and abortiveness of the *de facto* corporation. The former South Carolina corporation law is an instance. Here the incorporation process was enmeshed with statutory mandates regulating the raising of capital by subscriptions *before* filing the incorporation papers, by requirements of advance newspaper notices of incorporation and finally, by ambiguous provisions for filing with both the Secretary of State and the county clerk.[11]

Requirements and complexities such as these derive historically from opposition to corporate ventures and fears of

11. Indeed, one section of prior law [S. C. CODE §12-60 (Supp. 1962)] was at least open to a construction which would require a corporation to record its incorporation papers (and presumably all other documents of like character) with the clerk of court of every county in which the corporation might do business.

the economic and political power of consolidated capital. These fears no longer control. Today it is, or at least should be, accepted that the corporation is a, if not *the*, normal form of doing business, and that it should be available as a matter of right for any person who is able to comply with simple minimum requirements for incorporation. For this reason, the South Carolina statute, like the Model Act, seeks to simplify as far as possible the incorporation process, and to eliminate needless technicalities.

A. *Who May Incorporate*: The new South Carolina law departs from the Model Act[12] and, indeed, from the corresponding provisions of most corporation laws,[13] by the explicit authorization for "[o]ne or more persons, having capacity to contract" to organize a corporation.[14] This provision, first of all, lays at rest any possible doubt as to the validity of the one-man corporation[15] by recognizing it, in the most emphatic way, as a separate and distinct legal entity whose limited liability is not forfeited by the fact that all the stock is held at all times by a single person. Not only is the one-man enterprise the logical working-out of the legal separation of the shareholder and his corporation, but because it is a permanent part of the corporate scene it should have full legal recognition.[16] Secondly, authorizing a single incorporator avoids the present ritual of recruiting "dummy" incorporators from law office or client personnel. Quaint and pleasant as this time-honored liturgy may be, it is hardly worth mandatory perpetuation through a statutory requirement, as is the case in most states.

The same provision also has another interesting feature. By its use of the term "person," it follows from the definition of that term[17] that non-natural persons, including partnerships or other corporations, may be incorporators. The

12. MODEL ACT §47.

13. Some states are substituting a single for former multiple incorporators, *e.g.*, New York (N. Y. BUS. CORP. LAW §401) and the new Iowa statute (§48) continuing the long-standing and evidently satisfactory prior Iowa law (IOWA CODE §491.2).

14. S. C. §4.2.

15. Note the surprising invalidation of a one-man corporation under former North Carolina law (which required, *inter alia*, three incorporators, three directors, three officers), in Park Terrace, Inc. v Phoenix Indem. Co., 241 N. C. 473, 85 S. E. 2d 677 (1955), *aff'd on rehearing*, 243 N. C. 595, 91 S. E. 2d 584 (1956), overruled by N. C. GEN. STAT. §55-3.1 (1960).

16. Compare S. C. §8.3(a) which permits a one-man "board of directors" for a one-man corporation.

17. S. C. §1.2(a).

new Iowa corporation law,[18] for example, has done this, and it seems a perfectly sound procedure.[19] It recognizes that corporations are often the real party in interest, especially in forming subsidiary or affiliated corporations or corporate joint ventures. Moreover, corporations, especially banks, are not debarred from performing the fiduciary duties of trustees; and indeed under the Federal Trust Indenture Act of 1939, two trustees—one of whom must be a corporation—are required for every indenture under which certain creditor securities are issued.[20]

The incorporation process itself is completed when the incorporators execute, acknowledge, and file the articles of incorporation. In accordance with the general filing procedure, corporate existence begins immediately as of the date endorsed by the Secretary of State on the articles of incorporation.[21] Like the Model Act, and unlike present South Carolina law,[22] raising capital is not a condition precedent to incorporation, although it is necessary before the corporation begins to do business, aside from expenses of organizing the corporation and obtaining subscriptions or share payments.[23] Similarly, the organization meeting follows the corporation's birth, like the Model Act but unlike prior South Carolina law.[24]

B. *Articles of Incorporation*

Section 4.3 of the South Carolina statute contains a fuller statement respecting the contents of the articles of incorporation than does Model Act Section 48. This is not designed to make the drafting of the articles more complex, but to bring home to the attorney that he has the fullest freedom, consistent with the statute, to utilize provisions which will suit the particular, perhaps unusual, needs of his client.[25] Section

18. IOWA BUS. CORP. ACT §§48 ("One or more persons as defined in this Act . . .") and 2(1) ("person" includes a corporation, partnership, association, etc.).

19. It may be clumsy for a corporation to act as incorporator, since it must do so through natural persons; and under the South Carolina law, presumably they would be the persons entitled and required to execute corporate documents under the general provision (S. C. §1.4) for executing documents.

20. §310(a), 15 U. S. C. §77jjj(a).

21. Implied in the general language of S. C. §1.6, it is specifically reaffirmed in the chapter on corporate organization in S. C. §4.4.

22. S. C. CODE §12-58(7), 12-58(9) (1952).

23. S. C. §4.6(a); MODEL ACT §51.

24. Compare S. C. §4.7 and MODEL ACT §52 with S. C. CODE §12-58(8) (1952).

25. S. C. §4.3(a)(8).

4.3 thus places beyond doubt the validity of provisions which have in some states given rise to a charge that they violate the terms of the statute by deviating from a supposed "corporate norm." Such clear authority is also important because it ties in with the numerous statutory provisions which declare a rule of law "except as otherwise provided by the articles" or "subject to the articles" or similar language authorizing the draftsman to deviate from some flat rule of law in the interests of a flexible approach for his client.[26]

Here, a linguistic point is worth noting. The language of the Model Act, sections 48(d) and (f), setting forth all-important provisions as to the number and type (par or no-par) of shares, and classes and series, if any, is unnecessarily intricate and involved. Section 4.3(b) of the South Carolina statute, retains the substance of this material, but makes it more understandable by breaking down some of the lengthy provisions into short sentences divided, where necessary, into clearly marked clauses.[27] Indeed, there are other instances where the Model Act is characterized by an undue complexity of statutory language which can be simplified for the sake of clarity and precision.[28]

C. *Minimum Capital Requirement*

A vexing problem in any corporation law revision is the decision whether or not to require that any capital be paid in before business is begun. There is a sound argument for not requiring any statutory minimum of capital. On the one hand, an amount large enough to do any good would prove intrinsically unworkable and would probably drive many corporations out of the state. On the other hand a nominal capital does not of itself assure the financial soundness of the enterprise. For this reason one may well applaud Virginia and North Carolina,[29] otherwise so diametrically opposed in their approach to corporation law, for the practical logic of their decision to require no specified minimum capital pay-

26. Like MODEL ACT §48, S. C. §§2.2(b) and 4.3(e) protect the articles from the temptation, succumbed to by attorneys in some states, to recite all the statutory powers of the corporation.

27. S. C. §§4.3(a)(7), 4.3(6).

28. A notable example is MODEL ACT §74, especially paragraph 5. For efforts at clarifying this procedure, see S. C. §6.27, and N. Y. BUS. CORP. ACT §623.

29. Compare N. C. GEN. STAT. §55-9 (1960) and VA. CODE §13.1-53 (1956).

ment before the business is started. This approach is consistent with the financial soundness and integrity of the corporation since there are, apart from any legal requirements, many economic and business pressures upon the incorporators to bring sufficient capital into the business at the outset. Under the common law, of course, a corporation may lose its limited liability in the case of gross inadequacy of capital relative to the corporate operations.

With some variations, South Carolina follows the Model Act section on this point. Thus, section 4.6 requires payment of a minimum of $1000 before the corporation begins to do business. Since $1000 is hardly adequate in any real sense, and since there is no assurance that even this small amount will remain in the corporation,[30] the theory presumably is that the compulsory payment of this sum may deter promiscuous incorporation. Perhaps it may induce persons to think twice before incorporating; certainly, the figure is not so high as to be any hindrance to business. If this, then, is the theory, as the South Carolina revisers conceived it to be, then it can be carried a step further by requiring that one-half of this minimum be received in actual cash. This is intended to insure that some liquid funds, as distinguished from possibly unsaleable property, will actually come into the corporation before it launches its business. This $500 cash requirement, even more than the $1000 minimum consideration requirement of the Model Act, should deter the fly-by-night enterprise. The minimum consideration requirement is also strengthened by a provision that persons transacting business in violation of the capital requirements section shall be jointly and severally liable for the debts and liabilities of the corporation which arise out of such business. These requirements, so the South Carolina revisers believed, were desirable to counterbalance the ease of incorporation by a single person.

Practical considerations also dictated adopting a small capital requirement as against the more logical step of dropping the capital requirement. The old law had an unwieldy and complex requirement that the corporation, even before applying for incorporation, have subscriptions for at least fifty per-

30. Thus, the directors may allocate most of the consideration for no-par shares to capital surplus (S. C. §5.13(c)) which is available for distribution to shareholders if certain conditions are met. (S. C. §5.16; MODEL ACT §41.) In all events, stated capital may be reduced, and that reduction surplus is capital surplus. S. C. §§5.21 and 5.22(f); MODEL ACT §§63 and 64 (first paragraph).

cent of its authorized shares and receive at least twenty percent of the amount subscribed.[31] Surprisingly, many persons judged this capital payment requirement to be an important safeguard. The substitution of a $1000 consideration requirement is in large measure a substitute for this archaic statutory provision which, consistently evaded by the practice of paying in a small authorized share capital and thereafter raising it to the desired level without having to meet the 50-20% requirement as to the increase, nonetheless placed South Carolina at a disadvantage relative to other states whose laws were not saddled with this arachronism. However, it may well be recognized, as South Carolina business develops under the twin aegis of its new corporation and the Uniform Securities Act, that no minimum capital requirement is needed, and that protection of the public interest in the marketing of shares and other means of raising capital is best achieved through the securities laws rather than through the corporation law.

D. *Role of the Secretatry of State in the Incorporation Process*

Section 4.4 is a special provision addressed to the Secretary of State setting forth determinations which he must make before he accepts the articles for filing, thereupon initiating corporate existence as of the date he endorses the articles. This provision is exclusive. Not only is this a convenience to the Secretary of State and his office personnel, but it is assurance, written into law, of the attorney's freedom to insert into the articles of incorporation provisions which he thinks will best serve his client. It precludes any administrative officer from striking novel provisions as a condition for filing, thereby exercising a veto right over the content of the articles. The assumption here is that flexibility in planning the corporation outweighs the possibility that articles may be filed with provisions contrary to the act—an abuse for which there are adequate remedies. Hence, under the South Carolina law, the Secretary of State must file the articles once he has determined:

(1) That the incorporators have complied with the formalities of executing, acknowledging and delivering the articles for filing and have paid the appropriate fees;

31. S. C. CODE §12-58 (1952).

(2) That the articles set forth the minimum items of information specifically required by statute. This is essentially a ministerial duty, since the Secretary of State is not expected to go behind the assertions made in the articles of incorporation, but only to see that the requisite information appears. It is contemplated that he should do no more than ask whether and why a particular item of information that is required has been left out; and if he is assured that the point is inapplicable to the particular corporation, his function at this point is at an end.

(3) The Secretary is to determine whether the corporate name assumed by the enterprise is in accord with the corporate name requirements of the act, *viz.* whether or not the proposed corporation is assuming a name already registered or reserved, and thus accords protection to other corporations which rely on the registration and reservation of name provisions.

Beyond performing these essentially ministerial duties, he has nothing else to do than to file the articles. These specific provisions, then, are of benefit both to the Secretary of State, to the business which is incorporating, and to its attorney.[32]

IV. ADMINISTRATION OF THE CORPORATION LAW

The practice under the Model Act is to state in full the execution and filing procedures in each section which requires a corporation document to be filed with the Secretary of State. This procedure, of course, accords with the Model Act policy of eliminating or at least minimizing cross-references within the statute; and certainly no one could argue that any statute should be burdened with the complex cross-references characteristic of the Internal Revenue Code of 1954 or the complicated dependence of the Securities Act of 1933 upon its initial definitions. But the procedure used in the Model Act does carry the disadvantage of constant repetition of presumably identical material.[33] Both from the stand-

32. He also notes that the attorney's certificate required by S. C. §4.3(d) accompanies the articles (S. C. §4.4(d)).

33. Thus identical, or substantially identical, material appears at MODEL ACT §§49 (articles of incorporation), 56 (articles of amendment), 59 (restated articles of incorporation), 61 (cancellation of redeemable shares), 62 (cancellation of other reacquired shares), 63 (reduction of stated capital), 68 (articles of merger or consolidation), 68A (short form mergers), 75 (voluntary dissolution by incorporators), 78 (statement of intent to dissolve), 83 (revocation of voluntary dissolution proceedings),

point of the lawyer and the personnel of the Secretary of State's office, complete accuracy and safety would require that each time a document is prepared or is offered for filing, the execution and filing provisions applicable to that particular document must be consulted and studied for assurance that the precise procedure has been followed. Apart from this consideration, in general provisions such as those appearing in the South Carolina law, it is possible to speak with much greater detail—to the advantage of both attorney and Secretary of State—than would be feasible if the execution and filing requirements must be repeated some 15 or 20 times in the course of the act.

For these reasons, the new South Carolina act, like most new corporate laws, sets forth, in three sections in the initial chapter of the act a fully uniform procedure for executing, verifying, and filing all corporate documents required to be filed with the Secretary of State. This uniform procedure also has the endorsement of the Secretary of State who will administer the law in this State. Each section which requires public filing of a document makes a clear and specific cross-reference to these initial sections, thereby eliminating the repetition of material which is or should be identical.

The first of these general sections[34] requires the execution of one original and one conformed copy of each document. It then specifies the officers or other persons who are to sign the documents, with sufficient detail to insure that no document will be invalid solely for want of an authorized person to sign it. Both copies of the document are delivered for filing to the Secretary of State.[35] Upon receiving the documents and the required fees and taxes, he then files the document and certifies the filing of the original document by an endorsement upon its face. The filed copy thus endorsed is a convenient substitute for the formal certificate which under the Model Act the Secretary of State must usually issue; indeed, it is the certificate for all purposes. Also because the endorsement must be exactly dated,[36] this eliminates any question as to the exact time when the document was filed,

86 (articles of dissolution), 104 (application for authority of foreign corporation to do business in state), 113 (application of foreign corporation to withdraw).

34. S. C. §1.4.

35. S. C. §1.6. There is also a simple and uniform procedure specified in S. C. §1.5 for verification of documents.

36. S. C. §1.6(a)(3).

and is thus conducive to certainty. Vitiated only by showing actual fraud, the filing section conclusively presumes that any document becomes fully effective as of the filing date endorsed on the document, and the transaction is deemed to be consummated as of that date.[37]

The new South Carolina Corporation Law, like the Model Act, does not presently require that documents filed with the Secretary be also filed with the clerk of court of any county. As a consequence, no question arises as to the completeness of the action represented by the filed document. In its draft version,[38] the new law did require local filing, but set up a streamlined procedure by which the Secretary of State on receiving two copies of the document, would collect both his own and the clerk's fee and forward to the clerk both his fee and a copy of the document. Although eliminated in the bill introduced into the General Assembly, its restoration, in the form originally intended, is likely, since many members of the bar wish to have a copy of these public documents locally available. But, requiring the Secretary to assume responsibility for transmitting the second copy to the county clerk, would doubtlessly preclude any *de facto* corporation problems, especially since the document automatically becomes fully effective as of its filing date.

Aside from his powers and duties under the filing provisions, the Secretary of State has the usual authority in administering the corporation law, and on these points the South Carolina statute largely accords with the Model Act.[39] Thus, he functions under both statutes as an alternative agent to receive service of process,[40] although South Carolina, unlike the Model Act, also sets out a specific procedure by which foreign corporations doing business without authority in the State automatically designate the Secretary as an agent.[41] There are also specific requirements that the Secretary keep and maintain current lists of all corporate names,[42] and of

37. S. C. §1.6(b).
38. DRAFT VERSION, S. C. BUS. CORP. ACT §§1.6(a)(2), (6)-(7), and (c).
39. See, *e.g.*, S. C. §14.3 and MODEL ACT §133 (general grant of powers to Secretary); S. C. §§14.4-14.5 and MODEL ACT §§130-131 (interrogatories by Secretary of State).
40. S. C. §3.6(b) and MODEL ACT §13.
41. S. C. §13.14. S. C. §3.7 also continues a traditional local procedure for service of process on the Secretary of State in any suit against a non-resident director "relating to actions of" the corporation of which he was a director and "arising while he held office" as director.
42. S. C. §3.1(f).

the location of each corporation's registered office and the name and address of its registered agent.[43] Additionally, the Secretary performs a role in administering the provisions of the South Carolina law,[44] not duplicated in the Model Act, for dissoluton by charter forfeiture of corporations which fail to file annual reports, pay franchise taxes, or maintain a registered agent.

V. BOOKS AND RECORDS

South Carolina, like the Model Act, requires that each corporation keep full and complete books and records of account.[45] Both statutes also require the corporation to mail to any shareholder, on request, a copy of the latest balance sheet, "showing in reasonable detail" the corporation's financial condition as of the close of its fiscal year, and a profit and loss statement of its operations during that year.[46] Certainly, it is desirable that these documents be readily available, both to keep the shareholders informed as to the operations of the corporation, and because so many of the statutory requirements speak in accounting terms. The South Carolina statute, however, also requires that the corporation keep at its registered office copies of both the current financial statements as well as those for the preceding ten years or for such shorter period as the corporation may have been in existence.[47] These documents are available for inspection by any shareholder as a matter of right. This provision is important because it makes it possible for the shareholder to compare current with past financial statements. The availability of past financial statements, without delay or condition, is especially important to the new shareholder who has not had a chance to accumulate over a period of time the various past financial statements with which to make a comparison of the present statements. This statutory mandate is comparable to the requirement that corporations having securities listed on national exchanges show comparative figures which are most revealing as to the corporation's health. Apart from fairness

43. S. C. §3.4(b), S. C. §3.6(c), and MODEL ACT §13; both require the Secretary to keep lists of processes served on him as agent.
44. S. C. §§12.11-12.12.
45. S. C. §6.25(a); MODEL ACT §46, par. 1.
46. S. C. §6.25(c); MODEL ACT §46, last par. The South Carolina provision requires the statements to be prepared "[n]ot later than five months after the close of each fiscal year."
47. S. C. §6.25(c).

to shareholders, there is a good reason for furnishing shareholders with sufficient information rather than erecting roadblocks. Such protection encourages the flow of funds into corporate enterprise by persons who have at least the assurance that they can readily obtain some information bearing on the status of their investment and the financial facts pertinent to that question. One would suppose that the ready availability of information regarding listed stocks, required by the Securites Exchange Act of 1934, has played no small part in promoting investment by persons who would otherwise not have ventured into the money markets. The availability of such information should similarly promote the flow of local funds into local enterprises, not subject to the broad disclosure of the affairs of listed corporations.

Other documents must be kept on file by the corporation for inspection by any shareholder. These include a current copy of the by-laws and also a fully conformed copy of every document required by the act to be filed with the Secretary of State.[48] Since a conformed copy must in all events be delivered to and endorsed by the Secretary of State when he files the original copy, this proves no burden. In essence, it is the equivalent to making available for shareholder inspection the formal certificate issued by the Secretary of State under the Model Act procedure. The net effect, then, is that the corporation must maintain at its registered office certain basic documents bearing upon the financial condition, authorty, and activities of the corporation, and these documents and information must be furnished to any shareholder on request at business hours.

All documents and papers, other than those specifically required to be kept at the registered office and to be made available on demand by any shareholder, are subject to the general provisions relating to shareholders' inspection rights. Here the South Carolina law follows the Model Act,[49] with various additions which are designed to protect the corporation. Like the Model Act the shareholder entitled to inspect corporate books must be one who has been a record holder for at least six months; but unlike the Model Act provision, this right extends also to one who has five percent of the outstanding shares *of any class*, or who with other shareholders

48. S. C. §6.25(d).
49. Compare S. C. §6.26 with MODEL ACT §46.

comprises the required five percent of any class of stock. The South Carolina revisers saw no reason for the Model Act's unusually strict requirement that the five percent holder must be measured against the corporation's total number of shares outstanding. This is particularly harsh in the case, not unknown, of the holder of a relatively small class of preferred shares, particularly because even the entire number of preferred shares of a given class might not comprise five percent of the outstanding shares of all classes, and the shareholder would be automatically denied inspection rights. Yet, it is often in the case of a preferred shareholder that protection may be most needed.

With this provision designed to insure fairness, both the South Carolina and the Model Act seek to isolate and exclude the "strike" shareholder or the unscrupulous competitor using a few shares of stock in the corporation to gain access to the corporate books. The procedure used, however, is different. Under the Model Act,[50] the officer or agent who refuses a shareholder's inspection demand must pay a ten percent penalty and any other damages resulting from his refusal; but when sued, the officer may defend on the ground that the shareholder, within a specified period of time, had sold a list of shareholders or aided others in doing so or had improperly used information obtained from corporate books. The South Carolina law takes a different approach here, derived from the recent New York Act.[51] First of all, the corporation or its transfer agent or registrar may deny inspection if the shareholder refuses to furnish an affidavit that the inspection is not for an improper purpose, defined as in the Model Act.[52] Any shareholder who has a legitimate purpose and nothing to hide would normally file the affidavit without protest, save perhaps as a point of honor. However, if inspection is denied for failure to file the affidavit, the validity of such refusal is tested, not in a penalty suit, but when the shareholder on his own seeks a court order for inspection.[53] Under a show cause procedure, the corporation explains its denial of inspection. This procedure may result in any appropriate judgment granting, denying, limiting, or otherwise conditioning the shareholder's right of inspection. The court would pre-

50. MODEL ACT §46, par. 3.
51. Compare S. C. §6.26(c)-(d) with N. Y. BUS. CORP. ACT §624(c).
52. S. C. §6.26(c).
53. S. C. §6.26(d).

sumably have discretion to appoint impartial individuals to inspect the corporate books for the information sought by the shareholder, and thus deny a shareholder the right to fish through the corporate books. As under the Model Act, the shareholder may inspect as of right only the books and records of account; to examine minutes of the board of directors or the executive committee, or reports and memoranda by officers and others in the corporation, and like documents, he must obtain a court order,[54] and the act contemplates that the corporation could absolutely refuse such inspection unless and until ordered by the court to produce.

Finally, the South Carolina law, considering especially the needs of shareholders of local corporations, may order books of a domestic corporation brought into the state for inspection in the state.[55] However, this can be done only through a court order, and there is a carefully prescribed power of the court to ease the burden on the corporation by authorizing it to bring into the state in lieu of books or other documents, "pertinent extracts therefrom or duly authenticated copies thereof." This recognizes the sound view of an early decision in this state that if the books of a domestic corporation could be kept in New York, as they were there, "they can be kept in California or Calcutta," so that "the statute could be circumvented and rendered of no avail by keeping the books beyond the limits of the state."[56] This represents an effort to strike a balance between the legitimate interests of local shareholders of a domestic corporation inspecting the necessary documents and papers within the state, and on the other hand the undeniable interest of a corporation in legitimately keeping its books at the center of its financial or industrial operations.

The new South Carolina law requires few formalities for meetings of shareholders and directors, and does not attempt to specify, beyond broad categories, the types of minutes and other records which should be kept. For example, it validates action taken by shareholders and directors without a meeting.[57] But the new statute does give every encouragement to corporations to keep and maintain records of their activities.

54. S. C. §6.26(f).
55. S. C. §6.26(e).
56. Self v. Langley Mills, Inc., 123 S. C. 179, 190, 115 S. E. 54 (1922).
57. S. C. §6.18 (shareholders); S. C. §8.12 (directors). MODEL ACT §138, validates only informal or irregular shareholder action.

The most notable section[58] in this respect provides that the facts recited in certain corporate documents "shall be *prima facie* evidence of the facts stated therein." These include minutes of meetings of shareholders, directors, committees, and various documents evidencing consent or waiver which are filed with the minutes. In order for the documents to have such an effect, they must be certified under oath of the president and of the secretary to be true and correct. This section should be a powerful inducement to corporations to maintain full and complete documents of their activities. On the other hand, if a document is not available or minutes were not kept, the corporate action taken is not invalid; but the problems of proof remain at the usual level of difficulty because the corporation is not able to take advantage of the section's *prima facie* rule. Another provision[59] similarly should encourage record-keeping by a corporation. This section codifies the prevailing American law as to transactions between directors and corporations, including a provision that no transacton in which a director is involved is void or voidable solely because he is present or participated in the meeting or his vote is counted if material facts as to his interest and the transaction are disclosed to the directors and are noted in the minutes of the meeting.[60] The objective throughout has been to encourage, by giving incentives to, the corporation to keep minutes; but not at the same time to penalize the loosely run corporation for its failure, so common in smaller enterprises, to keep minutes and documents according to accepted corporate etiquette.

VI. DIRECTORS AND OFFICERS

A. *A Corporate Norm: The Board of Directors*

The new South Carolina law closely follows the Model Act in treating directors and officers athough it contains a number of additional and supplementary provisions.

Like the Model Act,[61] the South Carolina statute[62] envisions as the "corporate norm" that "the business and affairs of a corporation shall be managed by a board of directors"; but

58. S. C. §14.9, derived from CONN. GEN. STATS. §33-415.
59. S. C. §8.16.
60. There are other grounds for validating a transaction between a corporation and an interested director. S. C. §8.16.
61. MODEL ACT §33.
62. S. C. §8.1.

much more than the Model Act, it legitimates departures from this standard of director control. Thus, section 8.1 makes the general mandate "subject to any provision permitted by this act to be contained in the articles of incorporation, the by-laws, or agreements among shareholders." The "subject to" clause thus ties in with innumerable provisions validating deviations from a statutory standard, especially by authorizing the corporation to handle its business and affairs other than by action of the board of directors. The deviation may be merely a matter of form: South Carolina, unlike the Model Act, expressly authorizes informal director action without a meeting if certain conditions are met.[63] Or, more importantly, the variation from the "corporate norm" may be one of substance. In the small corporation, for instance, day-to-day affairs are often managed directly by the shareholders, in contrast to the larger corporation whose day-to-day business is handled invariably by the directors and, in the largest, by compact executive and finance committees of directors and officers devoting full or nearly full time to the corporate business. Hence, various provisions recognize, on the one hand, the broad powers which may be delegated to executive and other committees;[64] and, on the other, the extensive power under the South Carolina law of shareholders to control action of directors.[65] Such permissible deviations from the grant of power to directors are thus examples of director action which may be "subject to" provisions of the statute and of the articles, in order to accommodate the widely divergent interests represented by the various groups which incorporate.

One may ask why not go all the way and permit the articles to abolish the board of directors altogether.[66] In many corporations, the board of directors is little more than a statutory formality, while all of the business is handled by the shareholders (who elect themselves directors if they elect anyone at all). Section 8.1 of the South Carolina law does not specifically authorize the corporation draftsman to abolish the board of directors; but there is no clear mandate in the new South Carolina law with which such abolition would be inconsistent. There is a calculated reason for this equivocal

63. S. C. §8.12.
64. S. C. §8.11; *cf.* MODEL ACT §38.
65. S. C. §6.22.
66. See Kessler, *The Statutory Requirement of a Board of Directors: A Corporate Anachronism*, 27 U. CHI. L. REV. 696 (1960).

position. On the one hand, the new law is reluctant to lay down a rigid prohibition which might throttle a line of development of the close corporation, especially since the statute has otherwise been so solicitious of the interests of small enterprises. On the other hand, there is no reason to encourage a situation in which there is, as is so often true in smaller enterprises, an enhanced likelihood of undue confusion between corporate and personal business affairs; undeniably, the board of directors, and ancillary formalities, does serve some purpose in underscoring the separate legal entity of the corporation.

B. *Directors and Their Meetings*

1. *Number of Directors*: The new South Carolina law, like the Model Act,[67] has a general requirement of three directors, but it then permits that if "all shares of a corporation are owned beneficially and of record by fewer than three shareholders, the number of directors may be less than three but not less than the number of shareholders."[68] In this way, the one or two man corporation need have only one or two directors respectively, although it may have as many more directors as it may wish. The requirement for three directors for a one or two man corporation seems somewhat unrealistic, as the additional man may well be a figurehead at best, a nuisance at worst. Of course, he may serve a useful function by furnishing a fresh point of view, or perhaps even mediating conflicting interests, but the possibility that this may occur justifies not a flat rule of law which would require a minimum of three directors for a one or two man corporation, but far-sighted planning by the lawyer who sets up the corporation.

2. *Increasing the Number of Directors*: The South Carolina law takes a stricter view on the increase or decrease of the number of directors than does the Model Act. Under the Model Act, section 34, "the number of directors may be increased or decreased from time to time by amendment to the by-laws," but under section 25 the "power to alter, amend or repeal the by-laws or adopt new by-laws shall be vested in the board of directors unless reserved to the shareholders by

67. MODEL ACT §34.
68. S. C. §8.3, following in substance DEL. GEN. CORP. LAW §141(b), as amended in 1961.

the articles of incorporation." Joining these two sections, the directors, by amending the by-laws, on their own may increase or decrease the number of directors' seats. In the case of a particular director who may oppose the views of the majority of the board, there seems to be nothing to prevent use of this device to abolish his post if it would not "shorten [his] term." It is true that under the Model Act any directorship vacant because of an increase in the number of directors may be filled only by the stockholders.[69] But as a practical matter, this does not alter the centers of power, considering the overwhelming likelihood that management nominees will be elected. Even so, no provision is made in the case of a decrease in the board of directors, since the shareholders have only the opportunity to fill those posts which at the time are vacant.

The South Carolina provision seeks to avoid this excessive possibility of insider control by permittng the number of directors to be increased or decreased only by shareholder action, either by amendment of the articles of incorporation, or by a by-law adopted by the shareholders, unless the board may do so under a by-law adopted by the shareholders delegating that power to the directors.[70] Thus the shareholders do retain some control over the increase or decrease in the number of members of the board of directors; and of course under the South Carolina law, like the Model Act, the vacancy created by an increase in the number of directors is filled only by the shareholders.[71]

69. MODEL ACT §36.
70. S. C. §8.3(b).
71. Section 8.7 dealing with removal of directors is not essentially different from optional Section 36A of the Model Act. The South Carolina section differs slightly from the Model Act provision that "if less than the entire board is to be removed no one of the directors may be removed if the votes cast against his removal would be sufficient to elect him if cumulatively voted at an election of the entire board of directors." The implication is that, if a director was elected by straight voting, although the statute or articles require cumulative voting (and the cumulative voting right will not be invariably exercised even when so required), that director may keep his seat if the votes against removal would elect him if cumulatively voted. In effect, on removal he may enforce a right which was waived at election. The South Carolina revisers believed that only the director who had *in fact* been elected by cumulative voting should be able to block removal under this formula. Therefore, S. C. §8.7(b)(2) provides that "no director who has been elected by cumulative voting may be removed if the votes cast against his removal would be sufficient to elect him if then cumulatively voted at an election of the entire board of directors." Thus, he may be re-elected to the board if the cumulated votes are sufficient; but in the election, all shareholders are subject to the statute which regulates the exercise of a cumulative voting right, including (in South Carolina) the protective provisions of S. C. §6.20(b).

3. *Notice of Meetings*: The South Carolina statute offers several provisions of general interest on notice and conduct of directors' meetings. As to special meetings of the board, unlike the Model Act, notice must be sent "by any usual means of communication not less than four business days before the meeting,"[72] unless the by-laws stipulate some other notice procedure. Thus, the by-laws may prescribe notice of two or three business days; and, as in the Model Act, waiver of notice, including waiver by attending the meeting, also relieves a corporation, which must call a hurried meeting, of notice requirements.[73]

Under the new law, attendance of a director at a meeting automatically waives notice, without further action on his part. The South Carolina law deals more specifically with the director who attends a meeting solely to object to transacting business on the ground that the meeting is unlawfully called. Unlike the Model Act, he must announce his objection, "At the beginning of the meeting," and if he does not object, then he may not do so later.[74]

4. *Informal Director Action*: The South Carolina law, as already noted, validates informal action by the directors "or members of the committee of directors without a meeting,"[75] on the premise that suspension of formalities for shareholders (as under the Model Act) could well be allowed to directors. In order to qualify either (1) all directors or committee members must consent in writing to the action taken, either before or after it is taken, and file the consent with the board minutes; or (2) it must be shown that all shareholders have actual knowledge of the action taken, and no shareholder made prompt objection thereto."[76] The latter provision in particular applies only to closely held corporations with few shareholders, in which case it is an easy matter of proof

Like some other states, South Carolina also provides, consistent with its policy of arming courts with the broad remedial jurisdiction, that the court may remove a director for "fraudulent or dishonest acts, or gross abuse of authority or discretion in discharge of his duties to the corporation." Such jurisdiction can be invoked only by shareholders owning at least five per cent of *all* outstanding shares of the corporation. S. C. §8.7(d). Between the strict standing requirement and the statutory standard, this desirable reserve power does not threaten honest management even if these have been business errors not adding up to breach of duty.

72. S. C. §8.9 (b).
73. S. C. §8.9 (c); MODEL ACT §§39, 137.
74. *Ibid.*
75. S. C. §8.12.
76. S. C. §8.12 (a).

that the shareholders actually know what the directors are doing, especially since the directors and the shareholders are often the same persons; indeed, it probably codifies case law on the point.[77]

5. *Officers*: On corporate officers, the South Carolina law offers more specific provisions than does the Model Act, although hardly contravening its spirit. Perhaps the most significant addition is section 8.13, now increasingly prevalent elsewhere, that while normally elected by the directors, "if the articles of incorporation expressly provide," the officers may be elected by the shareholders. Section 8.14 then protects the shareholder-elected officer by allowing his removal only by a vote of shareholders "unless the shareholders shall have authorized the directors to remove such officer or agent," *e.g.*, for misconduct, or perhaps to suspend him. This obviously protects the corporation when a shareholder-elected officer should be removed, and where it would be inconvenient to call a shareholder meeting to do so. Again, under section 8.14 vacancies in offices are to be filled by the directors unless the articles specifically reserve the vacancy-filling power to the shareholders, as in a small or medium size corporation. In any event the shareholder-elected officer will be found only in the small and (less likely) medium corporation, and perhaps even then he will be exceptional.

Unlike the Model Act, South Carolina specifically requires that officers be elected each year by the directors "unless otherwise provided," *e.g.*, by the by-laws.[78] A five-year employment contract, in effect, would "otherwise provide." Here the South Carolina law contemplates that such contract rights do not restrict the power, as against the right, of the board

77. The South Carolina law closely follows MODEL ACT §38 on the executive committee, except that S. C. §8.11(a) requires the executive or any other committee to consist of a minimum of three directors. It also specifically recognizes what is implied by the Model Act but should be explicit, that "other committees" as well as an executive committee may be established, *e.g.*, a finance committee or committee on salaries and bonuses, etc. S. C. §8.11(a) also adds to the Model Act limits on executive committee powers a bar to its "declar[ing] dividends or other corporate distributions," believing that this vital corporate power should be exercised always and only by the board itself. But this does not prevent the directors from getting the benefit of committee thinking on dividends, any more than committee incapacity to adopt a plan or merger or consolidation would bar the board from receiving, indeed adopting, the executive or finance committee's recommendations on a merger or consolidation. Finally, a clarifying section makes all provisions of the act relating to conduct of meetings of directors equally applicable to any committee action.

78. S. C. §8.13(c).

of directors to remove an officer with or without cause as the board may see fit—an application of the agency doctrine that a contract cannot inhibit the principal's power, although it may restrict his right, to remove so that he is liable in damages for breach of contract in removing his agent.[79]

C. *Duties of Directors and Officers*

1. *A Statutory Standard of Duty*: The South Carolina law goes beyond the Model Act by codifying the duty of directors on several vital points. First, section 8.15 commands directors and officers to "exercise their powers and discharge their duties in good faith with a view to the interests of the corporation and with that degree of diligence, care and skill which ordinarily prudent men would exercise under similar circumstances in like positions." The South Carolina revisers believed that a clear-cut statement of the duty of directors and officers would serve many good purposes. It would add clarity and precision to the statute, and thus give assurance to those who must act; it would provide a legislatively approved guideline as against one to be deduced from the often shifting language and always variable fact situations of the cases; and it would give the courts the authority of a statutory standard in assessing conduct in specific situations. The terms used, largely adopted from the corresponding New York provision,[80] but also reflective of the case law in South Carolina, have a background of meaning in corporation law, although their application will inevitably depend, as with any breach of fiduciary duty, upon the facts of a given case. That a statutory statement of duty cannot automatically determine all possible cases is, of course, no argument against a declaration of the standard.

2. *Corporate Transactions with Directors and Officers*: Section 8.16 follows several other corporation law revisions in authorizing transactions between corporations and their directors and officers, thereby clarifying the duty of directors

79. S. C. §8.13(g) follows North Carolina (N. C. GEN. STAT. 55-34(c)) by authorizing the president, unless otherwise provided by the by-laws, to "institute or defend legal proceedings whenever the dirctors or shareholders are deadlocked." This is helpful especially for the small corporation, and indeed, any corporation with two or some other even number of shareholders or directors. If directors or shareholders fear the president's power, it is a simple matter to remove it by negating it in the articles or by-laws.

80. N. Y. BUS. CORP. LAW §717.

and officers in a specific type of situation which frequently presents itself, especially in smaller corporations. Confused American case law on this point presents three distinct rules: that the contract between the corporation and an interested director or officer is voidable at the option of the corporation (1) regardless of non-participation by the director in the approval of the contract; (2) if it is unfair or if the interested director's vote was needed to approve the contract; and (3) only if the contract is unfair, whether or not the interested director's vote was needed to approve the contract. California's section 820[81] was the statutory pioneer in foreshadowing subsequent adoption elsewhere, notably North Carolina,[82] and New York.[83] South Carolina declares that "no transaction in which a director or officer has a personal or adverse interest," as defined, is "void or voidable solely for this reason or solely because he is present at or participates in the meeting or his vote is counted."[84] Emphasis is upon the adverb "solely," since the transaction may be attacked on grounds other than the director's presence or participation. Moreover, whatever the situation, there is no reason why a director's interest should have any bearing upon the existence or non-existence of a *quorum* at the meeting which considers the transaction, as distinguished from the *vote* by which the transaction is approved; and the new statute avoids some of the case law confusion by detaching the question of a director's interest from the determination of a quorum.[85]

Section 8.16 then states three grounds[86] upon which contracts of interested directors or officers may be validated; (1) if a disinterested majority of the board of directors approves the contract with full knowledge of the facts, which must be recorded in the minutes; (2) if the shareholders ratify the interested director's contract with full knowledge of the facts, except that the interested director's shares may not vote; and (3) if the transaction is fair and equitable as of the time it is authorized or approved, with the party asserting fairness having to prove fairness. Thus, the third provision adopts as a catch-all the so-called liberal American

81. CAL. CORP. CODE §820.
82. N. C. GEN. STAT. §55-30.
83. N. Y. BUS. CORP. LAW §713.
84. S. C. §8.16(a).
85. S. C. §8.16(c). A similar rule applies to computing a quorum at a meeting of shareholders who approve the contract.
86. S. C. §8.16 (a) (1)-(3).

rule in upholding a contract irrespective of "conflict of interest" if the transaction is shown by the interested party to be fair and equitable.[87]

Moreover, this section embraces not only interested director, but also inter-corporate, transactions,[88] *e.g.*, between parent, subsidiary and affiliated corporations; and transactions between corporations, partnerships or associations in which a director has a "financial interest direct or indirect."[89]

3. *Loans to Insiders*: Section 8.17 of the new South Carolina law on loans to directors, officers, and shareholders differs substantially from the Model Act, which empowers a corporation "to lend money to its employees other than its officers and directors and otherwise [to] assist its employees, officers, and directors."[90] This rather laconic provision seemed unclear, and if clear then undesirable, because of the potential inroads of the "otherwise assist" clause upon the prohibition of loans, for it would seem to open many ways by which a corporation could, consistent with the Model Act, "otherwise assist" by guaranties, assumption of debts, and even outright gratuities, seemingly subject only to the vague limits in terms of wasting corporate assets. Accordingly, the South Carolina statute first forbids a corporation "directly or indirectly [to] make any loan of money or property to, or guarantee the obligation of" directors, officers, or their nominees, either of the corporation or an affiliate, parent or subsidiary corporation; similarly prescribed are loans upon security of the shares of the corporation or of an affiliate, parent or subsidiary.[91] The exception, however, is that any loan or guaranty may be made if approved either by all shares of the corporation, or by at least two-thirds of the shares not interested in or benefited by the loan or guaranty.[92] The risk to the corporation of a disinterested two-thirds majority lending money or guaranteeing obligations seems minimal. The alternative of unanimous approval recognizes the freedom of

87. In §8.16, the phrase "fair and equitable" is used instead of the California phrase, "just and reasonable" since the former is familiar from long use, especially in federal bankruptcy and reorganization statutes, and has sufficient case law to give some content to it.

88. S. C. §8.16(b).

89. Section 8.16 follows MODEL ACT §33, last sentence, in authorizing the directors (or under S. C. §8.16, the executive committee) to fix director compensation, except so far as the articles or by-laws otherwise provide.

90. MODEL ACT §4(f).

91. S. C. §8.17(a).

92. S. C. §8.17(b).

corporations to do what they wish (subject to creditor protection) if all shareholders approve. In all events, loans or guaranties require adequate security and the prevailing rate of interest. This provision seems particularly important, not to inhibit the reputable corporation, but to conutrol abuse by the very small or medium size corporation where unscrupulous insiders may use corporate powers to advance their own interest to the detriment of both the corporation and of the shareholders.

4. *Indemnification*: The question of indemnification of directors and officers is a delicate one upon which state laws greatly vary. Ths is an extensive topic in and of itself, and a survey article of this sort could not appropriately analyze the arguments for and against broad and restrictive indemnification provisions. Model Act section 4(*o*) treats indemnification as a corporate power which is broadly defined. South Carolina, however, follows California in dealing with indemnification as a matter of the *right* of the person to be indemnified.[93] Apart from the content of the new South Carolina provision or the merits of its resolution of the arguments against and for indemnity rights, it is believed that a specification in terms of right of director or officer to be indemnified is superior to a provision empowering the corporation to indemnify. Briefly, any present or former director, officer or employee as well as certain others have a right to reimbursement of expenses incurred either in a civil or criminal action, if (1) he has been successful on the merits and has not been found guilty of "negligence or misconduct in the performance of his duty to the corporation," or (2) the court awarding indemnification finds that he "fairly and equitably merits indemnification." A similar "fair and equitable" standard permits the person to be indemnified for a judgment paid by him or a settlement approved by the court. In short, indemnification is controlled by the court, not by the directors, and these rights are exclusive under the South Carolina law. The basic objective here is to avoid misuse of corporate funds by indemnifying guilty directors and officers, and especially to avoid indemnification of a director or officer for the funds paid in settlement of a derivative suit. Invoking court processes to control indemnification does not

93. S. C. §8.18.

imply mistrust of corporate management, but it is the best way to remove incentives to misconduct in this area.

5. *Why a Statutory Statement of Director Duties*: These last provisions dealing with the duties of directors and officers represent a judgment of the South Carolina revisers that a statute should declare, at least in some areas of dispute and uncertainty, high standards of conduct, and give some effective enforcement to them, rather than assume (somewhat unrealistically) that they will be always respected. Unquestionably, the trend of corporate law has been towards high standards more explicitly stated and more readily remedied when breached. The enforcement of higher standards is conducive to confidence in corporate enterprise, and this in turn adds an inductment to investors to move funds into productive enterprise. One can hardly fail to note that vast increases in investment, and the opening of previously unavailable sources of money, have paralleled the development of effective securities laws beginning with the federal statutes of 1933 and 1934. Moreover, the best of business adheres to at least as high standards as those which even strict statutes set forth, for sound business recognizes the futility of organizing commerce (including raising money) without mutual trust. From this standpoint, then, articulation of and remedies for breach of high standards should not impair the interests of corporate enterprise but rather should be to its advantage, if only for its long run encouragement of investment. Apart from this affirmative justification, there is also the negative angle, that many, probably a minority, of enterprises refuse to adhere to proper standards to the detriment of many interests, including business as a whole. Especially is it necessary to protect shareholders of very small and medium size enterprises whose management is often far more contemptuous of shareholder interests than in the case of larger corporations. Because a state statute must regulate all corporations and protect all shareholders, some restrictive provisions are appropriate. But this does not assume that corporate organizers and management are rogues; Holmes' "bad man" theory of law properly has little application to corporation law. Rather, definition, clarification, and sound standards are the prime justifications.

VII. SHAREHOLDERS

The chapter on shareholders is an unusually important part of any corporation law. First of all, it deals with that sensitive point of intersection between the sometimes opposed interests of management and of shareholders, and, indeed, probably the greatest number of corporate law cases come up in the context of a dispute as to management prerogatives and shareholder rights. Secondly, for this very reason, it is appropriate for a new corporation law, by precise and comprehensive regulation, to resolve in advance as many as possible of the problems which are both readily identifiable and also susceptible to statutory resolution; and it is in this area that a new corporation statute may well codify much case law. Thirdly, if this is so, it should be especially helpful in a jurisdiction which has had relatively little corporate law litigation and for which statutory rules can foreclose many questions which might otherwise require litigation not only to apply the rule (something no statute can avoid) but also to establish the rule in the first instance (something which codification can avoid).

The South Carolina chapter on shareholders omits almost no Model Act material, but extensively supplements it. Some of the more interesting provisions are discussed below.

A. *The By-Laws.* The statutory provision applicable to corporate by-laws is a crucial point in the power allocation between shareholders and directors. Depending upon the content of that section, virtually untrammeled power may be shifted to management, or the shareholders may retain some control over the directors. The most conspicuous application of the latter objective appears in the North Carolina law.[94] In contrast, the key Model Act provision, section 25, vests exclusive "power to alter, amend, or repeal the by-laws or adopt new by-laws . . . in the board of directors unless reserved to the shareholders by the articles of incorporation." It would be naive not to recognize that this grants near total control to the directors since in practice it will be exceptional for incorporators to reserve any or all power over the by-laws to the shareholders, and then only is this likely to occur in the truly closely held enterprise.

94. N. C. GEN. STAT. §55-16 (1960).

The South Carolina revision[95] does not permit such abdication of by-law power to directors, recognizing, as the Supreme Court said in *Rosers v. Hill*,[96] that the "power to prescribe rules for the government of business corporations reasonably is deemed an incident of ownership and the voting powers of the shares." Assuming that concepts of "corporate democracy" have been overdone by forcing an inapt political analogy upon the quite different corporate situation, nonetheless it is true that some shareholder control is the best means currently available to restrain management and also the best way to permit the investors, where interested, to have some voice in important decisions bearing upon their investment. Rejecting, then, the view opposed to "corporate democracy" —that management is entitled to total power over the corporation (subject only to scant statutory and articles of incorporation limits)—this argument recognizes some permanent role for shareholders in shaping the by-laws; and therefore the problem is to balance the director interest in prompt adjustment of the by-laws to current needs with the shareholder interest in preserving its role in the corporation.

The touchstone of the South Carolina provision is the guarantee that the by-laws are "subject always to the right of the shareholders to adopt, amend, or repeal" them.[97] Elsewhere it is stated that "such continuing power of the shareholders with respect to by-laws shall not be denied, inhibited or impaired by the articles of incorporation or by the by-laws or otherwise," other than as permitted by the act, and especially by the by-law section.[98] Starting from this basic proposition, the statute gives joint power over the by-laws to the directors and to the shareholders. Indeed, the directors may always "adopt, amend, or repeal by-laws," and they may do so with respect to a by-law previously adopted by the shareholders "unless such by-laws shall forbid amendment or repeal or limit the extent to which it may be amended or repealed."[99] This contrasts with the North Carolna provision which forbids the directors to alter, amend or repeal the by-laws absent specific authority from the shareholders to do so.[100] The South Carolina law recognizing merit here, reversed the rule,

95. S. C. §6.1.
96. 289 U. S. 582, 588 (1933).
97. S. C. §6.1(c).
98. S. C. §6.1(d).
99. S. C. §6.1(c).
100. N. C. GEN. STAT. §55-16(a)(1) (1960).

in the interests of flexibility, and placed the burden upon the shareholders, if they wish to preclude amendment of their by-law by the directors, specifically to curb the directors' power in this regard, otherwise it may be changed by the directors under *their* by-law power. Were this not so, a shareholder adopted by-law which should now be changed because of changed conditions could never be amended except by calling a meeting of the shareholders for that purpose.

Moreover, the directors cannot use their power over the by-laws to effect a *de facto* destruction of shareholder power over the by-laws by requiring a quorum or vote greater than specified in the act, on the articles or a by-law adopted by the shareholders.[101] Otherwise, the directors could easily adopt a by-law which would require unanimous or greater-than-majority shareholder action to amend the by-laws, thus permanently hamstringing shareholder action on the by-laws.

The by-laws section of the new South Carolina law contemplates that directors and shareholders will normally work in harmony. The guarantees designed to prevent shareholders and directors from encroaching upon each other's by-law power would likely show their teeth only if there is a sharp contest between management and shareholders, and that is precisely the time when management would be most tempted to abuse an exclusive power over the by-laws.[102]

The new South Carolina law is, it is believed, the first jurisdiction to adopt the essence of the Model Act proposal for emergency by-laws in the event of nuclear attack or nuclear or atomic accident or disaster.[103] Like the Model Act, South Carolina specifies the points which may be included in the emergency by-laws, but it also broadly declares that "if emergency by-laws have not been adopted by a corporation, action by shareholders, directors, officers, agents, or employees during any emergency," as defined by the section,

101. S. C. §6.1(c).

102. One or two minor provisions are also worth noting. One requires that any action on the by-laws which is proposed to be taken at a meeting of the shareholders or directors must be included in the notice of meeting. S. C. §6.1(f). This notice is, of course, subject to the statutory provisions regarding waiver of notice and defective notice. As in MODEL ACT §48(i) any provision which may properly appear in the by-laws may be inserted in the articles of incorporation (S. C. §6.1(a)). This serves the small corporation where the bargain worked out between the shareholders may best be placed in the articles of incorporation which can be amended only by complying with statutory formalities; in all events the option exists for those who wish to use it.

103. Compare S. C. §6.2 with MODEL ACT §25A.

"shall be valid if it substantially is in compliance with this section or if it is otherwise necessary and practical for the emergency operation and management of the business."[104] This latter provision protects directors and others who act for the good of the corporation during an emergency but whose corporation did not have the foresight or opportunity to enact emergency by-laws. At most, any statutory provision (or by-law for that matter) can afford only the roughest guide in such a tragic milieu; and, without wading into details, it would seem sufficient to authorize, as the South Carolina law does, such action as is "necessary and practical" to operate and manage the corporation. This is also the general standard for those provisions which could be inserted in emergency by-laws under the main provisions of the act.

Because of the sweeping powers which emergency by-laws may confer upon directors, officers, and agents, the South Carolina revision carefully restricts the occasions for the effectiveness of such by-laws. They are to become "automatically operative upon and remain in force only during" the emergency, but upon its termination they "shall cease to be operative."[105] Moreover, the South Carolina law defines the emergency as arising from "any nuclear or atomic attack upon the United States" or "any nuclear or atomic accident or disaster occurring in or substantially affecting" South Carolina,[106] thereby distinguishing the calamitous nationwide impact of a "nuclear or atomic attack" from the possibly quite localized effect of an atomic or nuclear "accident or disaster." In short, there is no reason why emergency by-laws in South Carolina should take effect because of an accident in New Mexico or Idaho, but there is every reason for emergency provisions if a nuclear disaster should occur at installations at Aiken, South Carolina, or if an atomic weapon carried in a SAC mission were accidentally detonated across the border in North Carolina with substantial adverse effects in South Carolina. Beyond this, like the Model Act, the new law does not attempt further to define "emergency," since this would raise, at least, questions as to whether the "emergency" is one declared by competent governmental authority, or simply post-nuclear chaos existing in fact.

104. S. C. §6.2(c).
105. S. C. §6.2(b).
106. S. C. §6.2(a).

B. *Meetings of Shareholders*

1. *Call, Notice and Record Date of Meetings of Shareholders*: South Carolina adopts the flexible Model Act provisions which are designed to facilitate shareholder meetings and eliminate useless formalities. Like Model Act section 22, but unlike earlier South Carolina law,[107] shareholder meetings may be held either within or outside the state.[108] By adopting other Model Act provisions regarding notice of the meeting, the record date, waiver of notice, etc., the procedures and techniques for convening a shareholders meeting under the South Carolina law become virtually identical with those Model Act provisions which have been so extensively adopted in other states. As in Model Act section 26, a failure to hold the annual meeting not only does not "work a forfeiture or dissolution of the corporation," but also it "shall not affect otherwise valid corporate acts."[109] The objective here is to prevent the voiding of action taken by the corporation on the grounds solely that the annual meeting was not called at the proper time or a sufficient number of directors had not been elected to conduct the business of the corporation. Stated affirmatively some other ground must also be shown for voiding the action taken by the corporation. This accords wth modern corporate law objectives of minimizing the substantive effect of technical and formal deficiencies even though such formalities may be desirable and important from the standpoint of orderly conduct of business.

As to the record date for determining shareholders, the South Carolina law seeks to discourage that the old practice of closing the stock books is not at all the preferred practice, by first specifying the record date procedure and then permitting the closed stock transfer books only as an alternative.[110] Indeed, it may well be that, following the logical New York rule,[111] South Carolina will some day altogether abolish the clumsy procedure of closing the books.

2. *Power of Court to Order Meeting Improperly Postponed*: Section 6.4 of the new South Carolina law, based on

107. S. C. CODE §12-251 (1952).
108. S. C. §6.3(a).
109. S. C. §6.3(b): "A failure to hold the annual meeting at the designated time *or to elect a sufficient number of directors to conduct the business of the corporation*" does not invalidate acts or cause forfeiture. The italicized phrase does not appear in MODEL ACT §26.
110. S. C. §6.6(a),(d).
111. N. Y. BUS. CORP. LAW §604.

a Delaware statute[112] but not duplicated in the Model Act, deals expressly with the occasional though annoying problems arising from a failure to hold the annual meeting and to elect directors. If no meeting has been held for thirty days after the date specified by the by-laws or, absent such specification, for thirteen months after the previous annual meeting, any shareholder may apply to the appropriate court to order a substitute annual meeting to be held, and the court has full power to take the necessary steps to implement its order of a meeting. Such court action is hardly novel. Not only is there probably an inherent jurisdiction in equity courts to deal with the problem of the improperly postponed shareholder meeting, but also an increasing number of states have followed the Delaware lead and have made specific statutory provision in this area.[113] In addition, there is a small though useful body of precedent, built up especially by the Delaware chancery, dealing with the conduct of meetings ordered by the court or otherwise under its supervision. Apart from this, there are good reasons for specifically recognizing and regulating court jurisdiction to deal with wrongfully postponed shareholder meetings. The South Carolina section, at least, is predicated upon the conviction, expressed by the Massachusetts court, that "[t]he stockholders constitute the governing power of the corporation. Provision that there shall be a meeting every year for the election of officers [and presumably directors] confers upon the stockholders a valuable right of which they cannot be deprived by corporate officers."[114] Also, given the permissible high quorum requirements which increase the chances that shareholders meetings may be blocked, it is desirable to confer court jurisdiction. Finally, it is to be remembered that the power of the court in this area is discretionary, although a shareholder's standing is a matter of right.

3. *Special and Adjourned Meetings of Shareholders*: Like Model Act section 26, the new South Carolina law recognizes that special shareholder meetings may be called, and speci-

112. DEL. CORP. LAW §224.
113. See N. Y. BUS. CORP. LAW §603, and other jurisdictions cited at 2 MODEL BUS. CORP. ACT ANN. 437 (1960).
114. Albert E. Touchet, Inc., v. Touchet, 264 Mass. 499, 509, 163 N. E. 184, 188 (1928); see also Camden & Atl. R. R. v. Elkins, 37 N. J. Eq. (10 Stew.) 273, 276 (Ct. Err. & App. 1883).

fies those who may make the call.[115] Other provisions meet certain problems raised by special shareholder meetings. Thus, the statute specifically commands the appropriate officer to give notice of a special meeting called by a person entitled to do so, specifies the time within which it must be done, and prescribes the alternative procedure if the officer fails to give notice.[116] Similarly, a record date for such a special meeting is specially provided giving the person calling the meeting a right to fix the record date in accordance with the general provisions of the section.[117]

Unlike the Model Act, South Carolina deals specifically with the adjourned meeting,[118] essentially codifying decisions reached in Delaware. Distinguishing between meetings adjourned for more or less than thirty days, the statute provides that if it is for less than thirty days, fresh notice is unnecessary if notice was given when the adjournment was taken, but if for more than thirty days, the general notice requirements must be met. Similarly, notice must be given if at any adjourned meeting the corporation proposes to take up business which could not properly have been considered at the original meeting, thus precluding the possible abuse of noticing a meeting for certain purposes, adjourning it, and then taking up at the adjourned meeting, perhaps with a smaller quorum, business which the stockholders did not know would be considered even at the original meeting. The requirement that fresh notice be given is modified somewhat since the old record date may be used unless the directors wish to set a new record date.

4. *Conduct of Shareholder Meetings*: Several provisions not duplicated in the Model Act are helpful in the conduct of shareholder meetings. First, the requirement of a list of shareholders entitled to vote at the meeting follows Model Act section 29 in its major outline. However, the South Carolina law provides that the list requirement is satisfied, thus obviating preparation of a special list, if shareholder records

115. S. C. §6.3(d). As a matter of detail, in contrast to MODEL ACT §26 authorizing special meetings of shareholders to be called, *inter alia*, by the "board of directors," S. C. §6.3(d) permits the call by the chairman of the board or by "a majority of the board of directors."
116. S. C. §6.4(b).
117. S. C. §6.6(c).
118. S. C. §6.4(c).

already show the essential information.[119] This essential information is, of course, the name and address of each shareholder, alphabetically arranged or indexed by his name, together with his holdings, both as to number and, where applicable, as to class and series. If the stock books are already so arranged, there is no reason to require the preparaton of a special list.

Secondly, Model Act section 29 requires that the shareholder list be made available "for a period of ten days prior to such meeting." But since notice of the meeting may be given as long as fifty days before the date of the meeting, and since mailing out the notice will involve at least some of the labor of preparing a voting list, it would not seem burdensome for the voting list to be available for longer than ten days. The South Carolina statute meets this by providing that "[f]or a period commencing upon the date when notice of the meeting is given, and in no event less than ten days prior to the date of the meeting" the voting list must be kept on file either at the corporation's registered office or at its principal place of business or at the office of its transfer agent or registrar. These latter alternatives give a broader option to the corporation, and in this respect follow the more flexible provision of the Virginia code.[120]

Thirdly, with respect to the sanction for non-preparation or non-filing of the voting list, South Carolina takes a different approach from the Model Act, which awards to the shareholder damages against defaulting officer or other agent. In contrast, the South Carolina law[121] adopts a much better proportioned sanction by providing that if the requirements of the section have not been substantially complied with, the meeting shall be adjourned until there is compliance. This should be the strongest incentive of all to corporations to comply with the voting list requirements, in order to avoid delay and indeed possible court action in extreme instances.[122]

119. §6.7(a): "The requirement of a list shall be satisfied, and no list need be prepared, if the record of shareholders readily shows, in alphabetical order or by alphabetical index, and by classes or series if any, the information required to appear in a list of shareholders." The preceding sentence of §6.7(a) specifies the "information" in language identical with MODEL ACT §26, first sentence.

120. VA. CODE §13.1-30 (1956).

121. S. C. §6.7(e).

122. Like many recent corporations laws, although unlike the Model Act §6.17 of the South Carolina law provides for voting inspectors to insure an orderly and fair conduct of the voting—something which is highly desirable for all corporations, and for the shareholders, especially

5. *Regulating the Cumulative Voting Right*: South Carolina has, at least for the present,[123] retained mandatory cumulative voting as required by the South Carolina constitution.[124] But in order to meet some problems which can arise under cumulative voting, whether mandatory or permissive, two provisions, appearing recently in several new corporation laws, should prove most useful, and of general interest, whatever one's views on the merits of this controversial topic.

Under section 6.20 of the new law, a cumulative voting right, whether granted by constitution, statute or by the articles of incorporation, may be exercised only if one of two conditions are met. The shareholder who proposes to vote cumulatively either must give written notice to the corporation at least two days before the date of the meeting, or if he fails do do so he must announce his intention to vote cumulatively at the meeting, and he must make his announcement before the voting for directors begins. At this point, the presiding officer may, or must if a shareholder requests, recess the meeting. The recess permits all of the shareholders to work out the sometimes complicated mathematics of most efficiently using their cumulative voting right. In the past, shareholders have occasionally miscalculated their voting power under cumulative voting provisions, and a minority has been able to elect a majority or all of the directors of a corporation.[125] This can occur since, even when cumulative voting is declared "mandatory," shareholders may still, either from ignorance or other reasons, vote straight; but if some vote straight and others vote cumulatively, there may be a surprise for the straight voters.[126] Whatever the merits of cumulative voting, certainly no one should gain an advantage merely through surprise and the lack of opportunity for opponents to calculate the best use of their votes on a cumulative basis. Indeed such reasonable regulation of cumulative voting

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if an election is or is likely to be contested. The inducement to use voting inspectors, and one which especially benefits the corporation itself, is the provision that a report or certificate of the inspectors is prima facia evidence of the facts stated in the report, and also of the vote as the inspectors may state it.

123. S. C. §6.20.

124. S. C. CONST. art. IX, §11.

125. Locally, there is a hint in an old case, State *ex rel.* Springer v. Ellison, 106 S. C. 139, 90 S. E. 699 (1916), that such may have been the situation there, although the facts are too brief to be certain as to just what happened.

126. See the case cited in 1 MODEL BUS. CORP. ACT ANN. 532 at ¶3.15.

can be endorsed independently of provisions making it mandatory or permissive.[127]

6. *Provisions on Voting by Shareholders*: The South Carolina law, besides stating the general rule that each share is entitled to one vote per share except as limited "either absolutely or conditionally" by the statute or the articles of incorporation,[128] also authorizes the articles to confer voting rights on creditors.[129] Such rights may be granted "either absolutely or conditionally" and they may not be terminated except on written assent of two-thirds of the aggregate face amount of the creditor securities.[130]

As to voting by corporations, shareholders, etc., the South Carolina law generally follows Model Act section 31, but in some respects it is stricter and also adds certain other provisions.

For example, the Model Act forbids voting or counting towards a quorum any treasury shares or "shares held by another corporation if a majority of the shares entitled to vote for the election of directors of such other corporation is held by the corporation."[131] Everyone agrees, presumably, that the voting power of shares owned by a corporation in itself should be sterilized, in order to prevent the most obvious sort of self-perpetuation by directors. The question is whether to do so by a flat rule—such as that of the Model Act and also the 1961 New York revision[132]—which immediately poses the question as to whether a parent corporation's shares owned by its 49% subsidiary, which it "controls" in all practical purposes, shall be voted in electing directors of the parent. South Carolina follows Ohio,[133] Connecticut,[134] and Delaware,[135] in providing that "no corporation shall directly or indirectly vote any shares issued by it."[136] Although, admittedly, this leaves the matter more at large than under the

127. This has also been adopted in North Carolina, N. C. GEN. STAT. §55.67(c), and Connecticut, CONN. GEN. STAT. §33-325, although surprisingly, not in the 1961 New York revision.
128. S. C. §6.11(a),(b).
129. S. C. §6.11(d), following DEL. CORP. LAW §221, VA. CODE §13.1-32 (1956), N. Y. BUS. CORP. LAW §518(b), and others.
130. See, also, S. C. §6.14(i) making the proxy rules of §6.14 applicable to proxies given by creditors.
131. MODEL ACT §31, par. 2.
132. N. Y. BUS. CORP. LAW §6.12(b).
133. OHIO REV. CODE ANN. §1701.47(e).
134. CONN. GEN. STAT. §324(c) (Supp. 1959).
135. DEL. GEN. CORP. LAW §160.
136. S. C. §6.12(a).

Model Act, it avoids the implication of the Model Act provision that only treasury shares and shares held by a 50% subsidiary are disfranchised. But its prime objective is to prevent maneuvers to evade the prohibiton against a corporation voting its own shares, and the fact that it has survived in several important commercial jurisdictions suggests that the absence of a flat rule is no great problem.

On voting by fiduciaries, South Carolina law approaches the problem somewhat differently from the Model Act. There the shares must be transferred into a trustee's name before he can vote;[137] the South Carolina law permits a trustee, indeed any fiduciary other than certain court appointed fiduciaries, to vote shares without transfer if he furnishes "proof satisfactory to the corporation of his authority to vote."[138] This technique would seem to have the merits of simplicity as against the requirement that the shares be transferred into the trustee's name. Of course, there is nothing to bar transfer into a fiduciary's name, and the South Carolina law specifically provides "that any fiduciary may vote shares which stand of record in his name."[139] As in the Model Act,[140] shares held by executors, administrators, guardians, or other court appointed fiduciaries may vote without transfer of shares into their names although the new South Carolina law[141] requires that they prove their appointment as a condition to voting.[142]

A useful provision of the South Carolina law also deals with the case of shares jointly owned by, among others, fiduciaries, joint tenants, and tenants in common. Here the act of a majority binds all, except in an even division in which case the vote on the shares is equally divided between the factions.[143]

137. MODEL ACT §31, par. 6.
138. S. C. §6.12(d).
139. S. C. §6.12(c).
140. MODEL ACT §31, par. 6.
141. S. C. §6.12(d).
142. Other provisions permit a minor to vote shares standing of record in his own name and forbid him to disaffirm the vote (S. C. §6.12(e)), and authorize any partner to vote shares standing in the name of a partnership, and any general partner to vote shares standing in the name of a limited partnership (S. C. §6.12(i)). S. C. §6.12(b) essentially follows MODEL ACT §31, par. 5 as to shares standing in the name of other corporations, except to specify the corporate personnel to whom the corporation whose shares are being voted may safely look for authority to vote, absent some contrary specification in the by-laws of the corporation in whose name shares stand of record.
143. S. C. §6.15. See also OHIO REV. CODE ANN. §1701.46(E) and N. C. GEN. STAT. §55-69(f).

7. *Proxies*: A distinctive provision of the new South Carolina law attempts to regulate, in perhaps greater detail than any other state corporation law, the proxy system. It thus recognizes that shareholder action is today usually a matter of giving a proxy to vote the shares rather than voting or otherwise personally participating. Because this is true not only of the large but also of many small and medium size corporations, it seems important to protect this essential link between the shareholder and his corporation and to eliminate various abuses. For this, there is ample precedent both in statutes and rules administered by the Securities and Exchange Commission, especially section 14 of the Securities Exchange Act of 1934 and its regulation 14, and in some few state laws. The overall object is to afford a degree of protection to the interest of the shareholders and at the same time lay down some ground rules for management in soliciting and using proxies.

The touchstone of the section adopts the SEC language forbidding solicitation of proxies on the basis of "false and misleading" statements or omissions with respect to any "material fact."[144] It is believed that this prohibition can be effective without administrative machinery, since if the section is violated, shareholders can go to court, show the abuse or violation, and secure from the court, acting as an equity tribunal, any needed orders to prevent further violations or undo the effect of prior violations. Since many large corporations are often subject to the SEC proxy rules, and since most of them follow ethical practices, there is little restraint upon management prerogatives and the beneficial prohibition against fraudulent solicitation is extended to smaller corporations. Indeed, these are usually the worst offenders, and their shareholders most need such protection.

Other provisions of the proxy section clearly specify the character and duration[145] of a proxy, in the process codifying much relevant agency law, since a proxy is a type of agency. Thus the appointment of a proxy to vote a shareholder's stock "shall be (by) printed or written proxy executed by the share-

144. S. C. §6.14(e).
145. Like MODEL ACT §31, par. 3, under S. C. §6.14(c), a proxy becomes invalid after eleven months. To prevent evasion, S. C. §6.14(c) provides that "[e]very proxy shall be dated as if its execution and no proxy shall be undated or postdated." See Securities Exchange Act Rule 14a-10.

holder . . . or by a telegram or cablegram appearing to have been transmitted by a shareholder."[146] It is expressly provided, with an important exception,[147] that all proxies are revocable, and are in fact revoked by later proxies as well as an instrument of revocation. But a proxy holder's authority is not revoked by death or by the shareholder's supervening incapacity unless written notice is received by the corporation. Moreover, a shareholder's appearance at the meeting does not of itself revoke the proxy; to do so, he must notify the appropriate officer or give notice at the meeting.[148]

C. *Election of Directors*

The South Carolina law follows the Delaware statute for judicial review of the election of directors and appointment of officers.[149] In this grant of jurisdiction, procedure is specified and the court empowered to make all necessary orders, relative to notice to all interested parties, issuing subpoenas and interlocutory orders to restrain action while the case pends.

The key provision is the relief which the court may grant. With respect to an election of directors or an appointment of officers it can (1) confirm the result, (2) set it aside and, if the facts warrant, declare other candidates elected or appointed, or (3) vacate the election and remand for a new election, with or without a special master to supervise it. This adopts the broad Delaware powers as against the narrow New York relief which was limited to confirming the election or ordering a new one. In addition, the court has explicit jurisdiction under this section to determine the shareholders entitled to vote, although there would probably be an implied power to do so.[150]

The remedial provisions of this section may be invoked by the defeated candidate for a directorship, a shareholder of record, or indeed by a shareholder seeking what is essentially a declaratory judgment as to the validity of an election. The Delaware experience shows some use of this sort of provision,

146. S. C. §6.14(b).
147. The exception is for irrevocable proxies, S. C. §6.14(f) based on N. Y. BUS. CORP. LAW §609, discussed in detail below.
148. S. C. §6.14(c).
149. S. C. §6.19, following especially DEL. GEN. CORP. LAW §§224-227. See also CAL. CORP. CODE §§2236-2238, N. Y. BUS. CORP. LAW §619, N. C. GEN. STAT. §55-71, and VA. CODE §13.1-42.
150. S. C. §6.19(d)(3).

although the number of cases seems moderate, and unlike derivative suits this statutory power given to the courts seems to have generated no particular outcry against "strike" or other abusive litigation. On balance, then, it seems decidedly beneficial, even if there is occasional abuse or delaying maneuver, to provide a clear cut statutory procedure in lieu of the cumbersome common law *quo warranto* writ, and the uncertain and inadequately defined equity jurisdiction which, if it exists at all, affords only narrow relief.

D. *Shareholder Control Devices and Procedures*

This topic covers the comprehensive South Carolina provisions on (1) voting agreements among shareholders, (2) voting trusts, (3) irrevocable proxies, and (4) agreements by shareholders respecting control of directors, in that order.

1. *Shareholder Voting Agreements*: Section 6.15 of the new law, which is not paralleled in the Model Act although found in a few other states,[151] specifically validates agreements by two or more shareholders as to voting their shares "if in writing and signed by the parties thereto." The section then directs that the "shares shall be voted as provided by the agreement, or as the parties may agree, or as determined in accordance with a procedure agreed upon by the parties." Examples would include—typically in the case of a deadlock among the parties to the agreement—an arbitration clause or an irrevocable proxy to vote the shares, to be invoked or become automatically operative under certain defined circumstances. However, there is no effort to specify the content of a shareholder voting agreement; the section only broadly validates it. There are several sound reasons for doing so. Apart from a need to dispel doubts created by *Johnson v. Spartanburg Co. Fair Ass'n*,[152] statutory recognition of the voting agreement is a reassuring guarantee of its validity as well as notice of its legal status to out-of-state shareholders. Secondly, since many of the purposes of vote pooling agreements, as here, may be achieved through the more elaborate and formal device of a voting trust, it is appropriate to foreclose any inference that the statutory voting trust is the exclusive method for consolidating shareholder voting power. Thirdly, this section is intended to place

151. See N. Y. BUS. CORP. LAW §620(a) and N. C. GEN. STAT. §55-73(a).
152. 210 S. C. 56, 72-73, 41 S. E. 2d 599 (1947).

the voting trust and pooling agreement on a parity and therefore, both are limited to a ten year period, after which both may be renewed or extended. Finally, such agreements have real utility in all sorts of corporations. They are, of course, typically associated with the small or middle size enterprise, but they may also be useful on occasions in public-issue corporations for control purposes, *e.g.*, massing voting power to stabilize the corporation during a period of dissension among shareholders, meeting a proxy challenge, presenting a strong front against a competitor's acquisition of shares, or steadying the corporation at an early stage in its life or after reorganization or some other bout with creditors.[153]

2. *Voting Trust*: The South Carolina law, like the Model Act, places voting trusts on a statutory basis and limits their duration to a ten year period.[154] It is intended that the statutory voting trust shall be exclusive. This is particularly important since in South Carolina, at least, common law has sustained voting trusts of a duration which seems excessive measured in terms of the well being of the corporation.[155] Hence, the Model Act ten year period was chosen. This overcomes the difficulty of breaking a trust of undue duration, and should prevent the concomitant long term freezing of management and incentive, perhaps accented by unduly conservative shareholders who refuse to allow the enterprise to embark on new adventures and seize new business opportunities. The voting trust, although limited to ten years, of course, is subject to the rights to renewal or extension of the voting trust.[156] But, renewal or extension does involve a new trust. The consent of all parties who wish to continue the trust is needed, since those who do not wish to do so "shall be entitled to remove their shares from the trust and promptly to have their share certificates reissued to them."[157] Hence, renewal or extension may well involve changed terms and conditions to meet changed circumstances.

Because of some decisions in other states which have invalidated a voting trust altogether if its duration does or may exceed the statutory period, the South Carolina law

153. The same objectives can, of course, be achieved through the more formal device of the voting trust.
154. Compare S. C. §6.16 with MODEL ACT §32.
155. Alderman v. Alderman, 178 S. C. 9, 181 S. E. 897 (1935). This result is not atypical in the United States.
156. S. C. §6.16 (e).
157. *Ibid.*

specifically provides that while the extended time period is unlawful, the trust is perfectly valid for ten years after its creation, but becomes invalid only after the expiration of the ten year period.[158] Several minor provisions clarify the voting trust rights. Thus, the agreement must remain on file for inspection both at the corporation's registered office (as in the Model Act) and with the voting trustees.[159] It is specifically required that both copies of the agreement at the registered office and the voting trustees must be kept up to date.[160] Again the voting trustees must maintain a complete and current list of voting trust certificate holders,[161] somewhat after the fashion of requiring the corporation to keep a complete and current record of the shareholders.[162]

3. *Irrevocable Proxies*: Irrevocable proxies can play a helpful role in the corporation, and as already suggested in discussing shareholder voting agreements, they may be used to break a deadlock on voting the shares. South Carolina[163] follows the New York law (which antedates but is continued by the 1961 New York Business Corporation Law[164]) in making a proxy irrevocable if (1) it specifically says that it is irrevocable, and (2) it is used for certain purposes specified in the statute. These purposes include giving the proxy to a pledgee of, or one who has contracted to purchase, the shares; to a creditor, who then holds the proxy as a form of security to protect his investment; and, of course, to a person under the terms of a voting agreement. In all of these situations, the proxy-holder could be loosely said to have what Professor Seavey calls a "proprietary interest" in the proxy.[165] Statutory provisions are especially needed to make irrevocable proxies useful in corporations, since this branch of the law is grievously confused by Chief Justice Marshall's

158. S. C. §6.16(f).
159. S. C. §6.16(b).
160. *Ibid.*
161. S. C. §6.16(c).
162. Several provisions give important rights to the voting trust certificate holders. Unlike the Model Act, the certificate holders are treated as shareholders for purposes of inspecting corporate books and records (S. C. §6.16(d)). Also they have shareholders' rights to dissent to proposed corporate action, and to be paid the fair value of their interests, although this may be changed or eliminated by the voting trust agreement (S. C. §6.16(g)).
163. S. C. §6.14(f).
164. N. Y. BUS. CORP. LAW §609(f), continuing N. Y. STOCK CORP. LAW §47-a.
165. Seavey, *Termination by Death of Proprietary Powers of Attorney*, 31 YALE L. J. 283 (1922).

cloudy concept of a "power coupled with an interest" or "engrafted on an estate," which alone may be irrevocable, as he declared in *Hunt v. Rousmanier's Adm'r.*[166] The statutory irrevocable proxy is of limited duration which is defined by (1) the termination of the situation for which it was created, *e.g.*, redemption of the pledge, expiration of the voting agreement, etc., and (2) in all events, its duration is not to exceed a ten year period, thus tying in its lifespan with that of the voting agreement and voting trust, and thereby avoiding any disadvantage time-wise from the control device chosen.[167]

4. *Shareholder Agreements Restricting Director Action*: Of a different character and somewhat in the nature of a catchall, section 6.22 of the new South Carolina law authorizes agreements among shareholders "respecting the management and affairs of their corporation or the relations of shareholders among themselves."[168] Such agreements are improper and not to be set aside solely because they may restrict the power or discretion of the directors of the corporation. Since they are chiefly useful to close corporations, and impractical, perhaps risky, in large enterprises, they are declared by statute to be valid only so long as shares of the corporation are not traded on an exchange or actively on an over-the-counter market. As with other control devices, the agreement has a maximum life of ten years, subject to renewal or extension. Its effect, by statute, is to relieve the directors of the liability which is then imposed upon the shareholders consenting to the agreement.

VIII. FUNDAMENTAL CORPORATE CHANGES

Although primarily following the Model Act both in broad outline and in detail, the new South Carolina law adds significant provisions in this field which should commend some general interest. Most of these are technical matters of detail, not reflecting differences of policy or theory.

166. 8 Wheat (21 U. S.) 174 (1823).

167. Irrevocability of a proxy does not run with the subject shares if acquired by a person ignorant of the irrevocable proxy, but this may be overcome by giving notice of "the proxy and of its irrevocability" on the share certificate, S. C. §6.14(h).

168. See also N. Y. BUS. CORP. LAW §620(b) and the prototype of all such validating provisions, N. C. GEN. STAT. §55-73(c).

A. *Amendment of Articles of Incorporation*

The chapter on amending the articles of incorporation distinguishes for convenience three varieties of amendment, in contrast to Model Act Section 54's single procedure for amending the articles by resolution of the directors followed by adoption or rejection of the amendment by the shareholders. Although the difference is largely formal, the South Carolina revisers believed that the three part division was conducive to clarity.

First, the articles may be amended in advance of the organzational meeting of the corporation, that is to say, after the corporation has come into existence but before it has readied itself to start doing business. At this early stage of corporate life, the articles may be amended by the "incorporator or if more than one incorporator, then by two-thirds of the incorporators."[169] Because the interest of the subscribers looms large at this point, the South Carolina law provides that any material amendment to the articles releases a dissenting subscriber from liability on his subscription.[170] This rescission right is a rule of fairness since after all the subscribers undertook to purchase shares in one type of corporation, and a material change in the articles may lock them into an enterprise of an entirely different character without their consent. The corporation itself is not unfairly prejudiced since it has not begun to do business and since it has elected to change its character after subscribers have agreed to chance their money in the enterprise.[171]

Secondly, the directors acting alone, without shareholder approval, may amend the articles with respect to the registered office or registered agent of the corporation by following the Model Act type procedure prescribed by the South Carolina law.[172]

Finally, South Carolina law follows the Model Act in the standard procedure for amendment by resolution of the board

169. S. C. §9.2.
170. *Ibid.*
171. In practice this situation should arise infrequently. First, it is unlikely that the business will be drastically changed between the subscription agreement date and the organizational meeting. Secondly, management could always defer amendment of the articles until the corporation has begun business, at which time the articles can be amended by the standard procedure, a board resolution with two-thirds shareholder approval.
172. S. C. §9.3.

and two-thirds approval of the shareholders, with the usual provision for class voting on the amendment.[173] The proposed amendment, if approved, is embodied in articles of amendment which are executed, verified and filed with the Secretary of State. In this connection there are several interesting provisions which are not duplicated in the Model Act.

Proceeding on the premise that shareholder participation in corporate affairs is to be encouraged, not discouraged, and following traditional local law on this point, the new statute requires the directors to submit any proposed amendment to the shareholders either at a special or annual meeting if requested by "at least ten percent of any class of shares of the corporation."[174] Thus, under this section ten percent or more of the class, *e.g.*, ten percent of the first preferred stock or five percent of the common stock (but not ten percent of a series), have a right to a shareholder vote on a proposed amendment of the articles. This procedure bears some analogy to the SEC's Rule 14A-8 under the Securities and Exchange Act of 1934 which requires a listed corporation soliciting proxies to permit shareholders, in certain circumstances, to include their proposals and a short supporting statement in management's proxy solicitation material. Although sometimes a nuisance, even the SEC rule seems not to have proved unduly burdensome. The South Carolina provision, in contrast, does not put management to any expense or effort on behalf of the shareholder, since his only right is to have his proposal come before the shareholders; and if the meeting consists of a pile of proxies on a table, he must carry the expense of soliciting them to support him. Unlike the SEC rule, which as worded does not effectively cull out proposals lacking even token shareholder interest, the South Carolina provision applies only to proposals which at least have sufficient merit to garner support from ten percent or more of a class of shares. With these limitations, it seems only fair to permit the shareholder who can claim such support to have a hearing.

The South Carolina law recognizes the interests of a closely held or medium sized corporation in authorizing the articles to require a greater than two-thirds vote to amend the articles,[175] *e.g.*, a 75%, 80%, or even a unanimous vote if that is

173. S. C. §9.4, following MODEL ACT §54.
174. S. C. §9.4(d); see S. C. CODE §12-403 (1962).
175. S. C. §9.4(c).

desired. This sort of permissive provision, together with similar authority for superstatutory vote requirements on mergers and other fundamental corporate changes, is conspicuously ill-adapted for larger corporations; but it is desirable for, and often used in, family or other close corporations seeking to keep the corporate powers and business exclusively within the select group and forcing, in effect, a unanimous or near-unanimous vote to make any basic change in the business. Despite the fact that these provisions can magnify friction into something much more serious, resulting in total deadlock, nonetheless there seems no public policy reason for not allowing these high vote requirements if the shareholders want them; the solution to deadlock is to provide special remedies (as South Carolina law does), not to look longingly at a supposed "corporate norm" of an exclusive statutory vote percentage. The statute gives a good deal of flexibility to the draftsman by providing that the high vote to amend the articles may apply to all amendments or to a particular amendment or category of amendments,[176] and may be conferred on all shares or any particular class of shares.[177] To prevent the superstatutory vote which is required to amend the articles from itself being amended out by the lower statutory vote, the new statute specifically provides that a superstatutory vote provision for amendment "shall not be altered, modified or removed except by the same vote which such provision [of the article] requires for amending the articles.[178] That is to say, an 80% vote for amending the articles may be removed only by an 80% vote.[179]

Section 9.8 of the new law offers a simple procedure for restating the articles of incorporation, especially designed to facilitate keeping the articles of incorporation and all the amendments which accrue from time to time in a single, clear, and up-to-date document. Model Act section 59 appears to require shareholder approval for all restatements of the articles. South Carolina law, following several other states on this matter, requires this only if there are added to the restated articles any new amendments which would themselves need shareholder approval, if separately proposed and

176. S. C. §9.4(c)(2).
177. S. C. §9.4(c)(3).
178. S. C. §9.4(c)(4).
179. A fourth method, if it can be called such, is by "written consent of all shareholders entitled to vote on such amendment." (S. C. §9.4(f)).

submitted to the shareholders. In short, if management wishes to do no more than collate all the amendments and provisions into a single continuous narrative document, it may do so by action of the board of directors without a shareholder vote,[180] but "the restated articles shall be specifically designated as such, and shall set forth the manner in which the restatement was authorized," that is, either by action of the directors, or by action of the directors plus shareholder approval of any new matter. Whenever the directors alone restate the articles, "the restated articles shall recite that it purports merely to restate but not change the provisions of the original articles . . . and that there is no discrepancy between such provisions and the provisions of the restated articles."[181]

B. *Mergers and Consolidations*

The South Carolina law closely follows the Model Act on mergers and consolidations, differences being chiefly minor linguistic matters. Two points, however, may be of general interest.

The first appears in section 10.3 specifying the information contained in the written or printed notice of the meeting to approve a merger or consolidation. The Model Act merely requires that written or printed notice shall be given . . . in the manner provided in this act for the giving of notice of meetings of shareholders, including the purpose of the meeting and a summary of the plan of merger or consolidation.[182] Elaborating on this, section 10.3 requires that the directors also distribute either a "copy of the plan of merger or consolidation or an accurate outline of the material feature of the plan," thereby insuring that shareholders receive full, accurate, and pertinent information on the proposed corporate changes. In addition, shareholders must be furnished with balance sheets and profit and loss statements of each of the merging corporations for the three preceding fiscal years—a provision not unlike the Securities and Exchange Act Rule, that full financial information on a merger or consolidation accompany the proxy statement.[183]

180. Of course, the directors may, in the unusual situation, restate the articles, and add thereto, without shareholder vote, any provision which the directors without a shareholder vote could insist, *e.g.*, new provisions relating to the registered agent and registered office.

181. S. C. §9.8.

182. MODEL ACT §67.

183. Securities Exchange Act Rules, Schedule 14A, Item 14 and 15.

Finally, the notice of merger must "contain a clear and concise statement, prominently displayed" of the shareholders' right to dissent to any plan of merger,[184] again following an SEC practice.[185] Although there are good arguments for dispensing with all shareholder appraisal rights after a fundamental corporate change, nonetheless it is orthodox that these rights are the price for escaping the rigid common law requirement of unanimous shareholder consent. The theory of the South Carolina provision is that if the right is available—and few indeed believe it practical to abolish it from statutes—it seems just to set forth in the appropriate place the fact that the right exists and how it is to be exercised. Indeed, because of the relatively restrictive procedure governing the exercise of these rights—a restrictive procedure found both in the new South Carolina law, the Model Act, and the statutes of most jurisdictions—it seems only fair to alert dissenting shareholders to possible pitfalls. For example, the shareholder must file a written objection before or at the meeting (a negative vote is not enough), and again within the space of twenty days after the meeting he must file another written demand for the value of his shares.[186]

Non-notice of these requirements, and the short time period for meeting them, may well result in shareholders forfeiting their rights. Certainly, there can be no injury to corporations or detriment to business in giving fair and accurate notice of the steps necessary to preserve their rights; and the statutory notice is an obvious and appropriate place to set forth these rights. In all events, if there is sufficient distaste for appraisal rights of shareholders, corporate revisers should face the problems squarely, develop the (often sound) arguments for abolishing them, and seek to discover some substitute procedure,[187] rather than to make inroads upon the share-

184. S. C. §10.3(b)(4). A similar notice must be given to "outside" shareholders of a subsidiary participating in a short-form merger with its parent (S. C. §10.5(a)(1(D)), and to shareholders entitled to dissent to a sale of corporate assets (S. C. §11.3(a)(2)).

185. See Securities Exchange Act Rules, Schedule 14A, Item 2, which requires that the "rights of appraisal or similar rights of dissenters with respect to any matter to be acted upon" be outlined briefly, together with an indication of "any statutory procedure required to be followed by dissenting security holders in order to perfect such rights."

186. See MODEL ACT §74 and S. C. §6.27.

187. Compare, for example, Section 72 of the English Companies Act of 1948, 11 & 12 Geo. VI, c. 38, authorizing a specified percentage of certain classes of shareholders to secure court review of the validity and fairness of amendments to the articles of incorporation. It should not be unfair or wholly impractical to abolish shareholder appraisal rights in this country

holder rights by technical and picayune requirements, and by suppressing information needed to exercise those rights intelligently.

Both the Model Act and the South Carolina law authorize merging a subsidiary corporation into its parent without shareholder action from either corporation.[188] Like the Model Act, although unlike Delaware,[189] South Carolina does not permit the reverse procedure of merging parent into subsidiary. In all three statutes, the "outside" share interest in the subsidiary may be replaced either by securities of the parent corporation, by obligations, cash or other consideration. The South Carolina statute contains a useful explicit statement that only the holders of shares in the subsidiary corporation other than shares held by the parent corporation are entitled to dissent to a merger, and that "holders of shares of the parent corporation" shall not be entitled to dissent and have payment for the fair value of their shares.[190] This is correct, of course, since in most instances a parent-subsidiary merger produces a merely formal change in the family of corporations.

Finally, by way of completeness the South Carolina law makes specific an implication of Model Act section 70 that one or more subsidiary corporations, either foreign or domestic, may merge under the provisions of a short-form merger procedure "into the parent corporation whether foreign or domestic."[191] The only conditions are that the general short-form merger section would apply except for the fact that the parent or one of the subsidiaries is a foreign corporation, and the jurisdiction of incorporation of the foreign

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and to substitute therefor a protective judicial procedure, as in England, which would evaluate the fairness of transactions for which at present appraisal rights exist (including mergers); such a proceeding would also consider the fairness of the share exchange ratio. It could be made summary with priority on court calendars to minimize delay, which in all events should be no more, and probably less, than the time consumed in litigation or settling up appraisal rights. If the percentage of shareholders required to petition for such review is significant, *e.g.*, ten or fifteen percent of a given class, there would seem slight danger of its use for "strike" purposes, particularly since the incentive of a money award — which is the outcome of successful appraisal right litigation and which is, of course, the motive behind all "strike" litigation — is absent, since the court would only be expected to confirm or set aside the transaction. Finally, this sort of substitute procedure would eliminate the drain of cash payments in settlement of appraisal rights.

188. MODEL ACT §68A; S. C. 10.5.
189. DEL. CORP. LAW §253.
190. S. C. §10.5(a)(4).
191. S. C. §10.7(b).

enterprise permits a short-form merger under "substantially the same terms and conditions" as does South Carolina. The revisers thought that this provision was helpful, and noted that it did not appear in the Model Act in the explicit terms stated here although it is implied by Model Act section 70's authorization of merger and consolidation between foreign and domestic corporations. Psychologically, if for no other reason, it would seem desirable to put beyond doubt the power of a foreign parent corporation to create a local subsidiary and thereafter merge the subsidiary into the parent. Similar considerations would apply to the reverse situation of a local parent and an out-of-state subsidiary.[192]

C. *Sale of Corporate Assets*

The South Carolina chapter on sale and other disposition of corporate assets contains some useful features not appearing in, but not inconsistent with the Model Act, which otherwise is closely followed.

Apart from making a useful linguistic change at the outset so that the statutory material becomes more readable,[193] the South Carolina revisers thought it desirable to mark out more specifically the vital distinction, upon which so much of this material turns, between sales of assets in, and those out of, the regular course of business. Objections to the Model Act statement were that it assumed as self-evident the distinction and thus afforded no guidance. Accordingly, the South Carolina revisers attempted to demarcate a distinction between these two types of dispositions.

The technique used was to adopt as guidelines or criteria, with some variations, certain useful provisions which in the North Carolina law[194] are the sole grounds for authorizing a sale of assets without shareholder approval. In contrast, the South Carolina provisions are not exclusive, for section 11.2

192. S. C. §10.5, also states that the short form procedure does not bar merger or consolidation under any other procedure; and, more importantly, that "any plan or merger which requires or contemplates any changes other than those specifically authorized" by the short form section "shall be accomplished under the provisions" of the general merger section.

193. MODEL ACT §§71-73 continually repeat the cumbersome phrase "sale, lease, exchange, mortgage, pledge or other disposition" of corporate assets. S. C. §11.1 initially defines the term "sale" to include all of these transactions (except that in South Carolina law, mortgages and like creditor transactions have special treatment, see text at p. 198, *infra*), and thus makes the substantive sections read more smoothly.

194. N. C. GEN. STAT. §55-112 (1960).

provides that whether or not an asset disposition occurs within the usual and regular course of business is determined by all the "circumstances of the transaction," including the character of the business in which the corporation is engaged at the time of or immediately preceding the transaction. For example, the disposition of real estate, even though constituting a major or substantial part of the assets of the corporation, by a real estate development company, would be a transaction within the "usual and regular course of business," because this is "the character of the business" in which that corporation is engaged at the time of the transaction. More specifically, a sale of assets may be considered to occur in the regular course of its business if one of the two following criteria is met: (1) the corporation was incorporated for the purpose of liquidating the assets or property disposed of; or (2) the sale is a transaction or one of a series of transactions to further the corporate business and not to terminate or dispose of it. The question whether a transaction is within or without the usual and regular course of business will always be essentially one of fact, as the South Carolina law recognizes; but the criteria suggested should be useful in delimiting the circumstances when it is necessary to secure shareholder approval as a matter of safety.

Another point is worth noting on sale of assets. South Carolina, unlike the Model Act but in accord with several other states, including some much concerned with shareholder interests, permits mortgage or pledge of corporate assets without shareholder approval,[195] unless such approval is required by the terms of the articles of incorporation.[196] Theoretically, perhaps, it is questionable whether, for purposes of deciding whether or not to require shareholder approval, to distinguish so sharply between transactions which can have a similar economic impact on the business. In practice, however, the distinction seems sound and workable, and apparently the discretion of management in entering into these

195. S. C. §11.4. Present South Carolina practice is clearly, and the uncertainty phrased, former statute (see S. C. CODE §12-102(4) (1952)) is apparently, in accord.

196. Unlike the Model Act, S. C. §11.2(b) authorizes the articles to require shareholder consent even for a sale of assets in the regular course of business. This not only accords with the policy of maximum freedom to shape corporate structure, but it is likely to be a very vital matter to the shareholders, especially in a close corporation which is probably the only type of enterprise which will reserve shareholder control over asset sales in the regular course of business.

credit transactions has not been seriously abused. After all, mortgages and pledges are credit transactions, and in purpose and form and result are usually different from sales, leases and exchanges of property, and thus they are more closely related to the "usual and regular" business of the corporation.

D. *Dissolution and Liquidation of Corporations*

South Carolina has largely followed the Model Act on dissolving corporations, with, however, several additional provisions.

Voluntary dissolution is more readily available under the new South Carolina law than under the Model Act. Thus, a dissolution resolution may be offered by twenty percent of *all* shareholders[197]—a sufficiently large number to cull out mischievous or publicity-seeking shareholders, since, absent serious internal troubles, it is unlikely that one-fifth of all shareholders will propose corporate suicide. Also, the articles of incorporation may authorize "any shareholder, or the holders of any specified number or proportion or class of outstanding shares," to dissolve the corporation "at will or upon the occurrence of any specified event or contingency."[198] Designed only for close corporations (since it is valid only so long as the corporate shares are not traded on an exchange or on an over the counter market), it helps to minimize differences between corporations and partnerships as a means of doing business.

Involuntary dissolution by court order, available generally as in the Model Act to break a deadlock, may be had, under the South Carolina law by alternatively showing irreparable injury (as in the Model Act) or, as a less stringent standard that "the business and affairs of the corporation can no longer be conducted to the advantage of the shareholders generally."[199] The desirability of a looser alternative test is shown by extreme judicial reluctance to dissolve a hopelessly dead-

197. S. C. §12.2(a)(2).
198. S. C. §12.14, following N. Y. BUS. CORP. LAW §1105. The appropriate court has jurisdiction to enforce this dissolution option. S. C. §12.15(a)(6).
199. The same criteria apply if "the shareholders are so divided respecting the management and affairs of the corporation" that irreparable injury will result or "the advantage to the shareholders generally" will be lost. This accommodates the small corporations, whose business is conducted entirely by the shareholders, perhaps even without directors.

locked corporation which may still be able to drift along at some profit, although the shareholders are at each others' throats. Hence, section 12.5(f) specifies that dissolution is not to be denied solely "because it is found that the business of the corporation has been or could be conducted at a profit."

The most significant innovation in this area is the adaptation for American use of section 210 of the English Companies Act of 1948[200] empowering courts to grant alternative relief under circumstances justifying dissolution. Section 210, as interpreted by English case law, enables the court to take all steps necessary to break a deadlock in a corporation, including, but not limited to, enjoining provisions of the articles of incorporation or the by-laws or resolutions, or even compelling a buyout of share interests. The English experience has been so successful that the only complaint is that the court's power is too limited, because presently too closely tied to a showing of need for dissolution.[201] Relief ordered under this section has included in one case a compulsory buy-out of shares,[202] and in another case a decree which, while not ordering the recalcitrant shareholder to sell out his interest, adjusted corporate affairs such that his attempted ruthless conduct would be harmless.[203]

South Carolina, accordingly, authorizes its courts to grant "such relief, other than dissolution as in its discretion it deems appropriate," including cancellation of provisions of the articles or by-laws or resolutions, affirmative directions to shareholders, directors or others, and a compulsory purchase at their fair value of shares of any shareholders either by

200. Companies Act, 1948, §210, 11 and 12 Geo. VI, c. 38.

201. See Elder v. Elder and Watson, Ltd., [1952] Sess. Cas. 49 (Scotland). The Jenkins Committee, which has reported a number of significant proposals for revising the English Companies Act, has recommended that Section 210 be amended to dispense with any showing of a need for dissolution, so that this provision will be converted into a general remedy for breach of duty by directors and other insiders and for settling or eliminating serious intra-corporate disputes. Company Law Committee, *Report*, Cmd. No. 1749, at 74-78 (1962). A similar recommendation has been made with respect to comparable provisions in the Companies Act (Northern Ireland) of 1932. Company Law Amendment, *Report*, Cmd. No. 393, at 10-12 (1958). The Draft Companies Code 1961 of Ghana §218 accords with the Jenkins Committee recommendations. Commission of Enquiry into the Working and Administration of the Present Company Law of Ghana, *Final Report* 160-162 (1961).

202. Scottish Cooperative Wholesale Society, Ltd., v. Meyer, [1959] A.C. 324 (H. L. 1958).

203. In re H. R. Harmer, Ltd., [1959] Week. L. Rep. 62 (C. A. 1958).

the corporation or by other shareholders.[204] Such relief may be prayed for by any person who under section 12.15 (corresponding to Model Act section 90) has standing to petition a court for dissolution, thus making the alternative relief available in the typical case of a director or shareholder deadlock. All relief, it must be stressed, is discretionary, and not a matter of right of any shareholder; and it is anticipated that courts will be discreet and sparing in the exercise of their powers. This is doubly important since, unlike the present English statute, relief is not necessarily confined to the extreme circumstances which call for dissolution. Rather it is available "whenever the circumstances of the case are such that *relief, but not dissolution, would be appropriate.*" Thus, for example, a critical deadlock in a corporation would give rise, under the South Carolina sections to several types of relief: (1) dissolution of the corporation, either on the standard of irreparable injury or inability of the corporation to function to the benefit of the shareholders generally; (2) discretionary relief as an alternative to dissolution; and (3) discretionary relief where the situation does not demand the drastic remedy of dissolution, but where some adjustment of intracorporate relations is needed.

Several reasons justify this new statutory jurisdiction. Most important is the increased likelihood of deadlock both under the South Carolina and other state statutes, which consistently authorize high vote requirements and shareholders agreements productive of deadlock. Absent the kind of relief South Carolina now authorizes, dissolution may be the only remedy. But because this is usually a harsh remedy, both for the shareholders (loss of investment), the corporation (loss of going concern value) and at times for the public, the courts should have a wider choice than that of dissolution or continuing a bad situation. Also, the English experience suggests that the mere fact that the relief is available is itself a strong incentive for shareholders and directors to work out their problems among themselves, since the threat of court action generates an attitude of reasonableness and conciliation. If this proves to be so, this new section has unquestionably done its job even better than if it is invoked in court.

204. S. C. §12.23.

IX. CORPORATE FINANCE

South Carolina closely follows the Model Act in its treatment of corporate finance. This embraces, first, the healthy trend towards broadening the corporation's authority to issue all types of shares recognized by the money markets as useful means of raising equity capital.[205] In addition, South Carolina goes beyond the Model Act in dealing specifically with bonds and debentures, including provisions on consideration for their issue,[206] their voting rights (if any),[207] and convertible issues of such securities.[208] In the second important area of corporate finance—dividends and other distributions —the major development attributable to the Model Act is the serious reliance of all modern corporation statutes (including South Carolina) upon accounting concepts, techniques and procedures, to define legal requirements, thereby giving to the law a degree of precision impossible under the older statutes with their uncertain and ill-defined terms.

A. *Shares and Their Issue*:

Although generally South Carolina adheres to the Model Act on types of shares, there are several differences worth brief notice.

1. *Redeemable Shares*: The Model Act authorizes, without elaboration, issue of redeemable shares, "of preferred or special classes."[209] This presents several problems. First, this wording leaves uncertain whether a corporation may issue redeemable common, since two highly respected courts, at least, have reached contrary conclusions on this point under statutes authorizing redeemable "preferred and special classes" of shares.[210] South Carolina settles the issue by ex-

205. Correspondingly, this removes uncertainties generated by old restrictive provisions. The former South Carolina law, for instance, left crippling doubt as to the validity of non-voting common shares, now dispelled by S. C. §§51.(a) and 6.11(b). Similarly, specification in the old law of permissible preferences and restrictions for no par "preferred capital stock" cast doubt on par value preferred; in all events, no statute should even give rise to a negative implication on so significant a matter. Similarly clouded was no-par preferred in series, and in all events authority was wholly lacking for directors to issue any shares in series. All of this is clarified under the new law.

206. S. C. §5.23.

207. S. C. §6.11(d).

208. S. C. §§5.24(b)-(d), 5.6(f).

209. MODEL ACT §14, par. 2.

210. See Starring v. American Hair & Felt Co., 21 Del. Ch. 380, 191 Atl. 887 (Ch.), *aff'd*, 2 A. 2d 249 (S. Ct. 1937) (holding that DEL. CORP. LAW §243(a), authorizing redeemable "preferred or special shares" does not permit redeemable common). *Contra*, Lewis v. H. P. Hood & Sons, 331 Mass. 670, 121 N. E 2d 850 (1954).

pressly forbidding redeemable common shares other than those of regulated open-end investment companies subject to the Investment Company Act of 1940.[211]

This prohibition seems justified. If redeemable common is permissible, a corporation could redeem such shares when financially threatened, although one had supposed that the common should bear the ultimate risk of loss or profit. The usual limitations—that shares may not be redeemed if the corporation is or would thereby be rendered insolvent[212]—would seem insufficient protection against weakening the corporation's financial position, either by dispersion of cash or paying of the redeemed shares of some type of creditor security. There are additional temptations since management, so far as it is identified with stock ownership, is usually most interested in the common. Thus, minority shares, especially those held by dissident shareholders, would be at the mercy of management or majority shareholders who, by calling in the stock at will, could destroy the independence of shareholders of matters committed to them by statute. Again, even though soundly managed enterprises, especially companies subject to compulsory disclosure, seem not to issue such stock, the risk of abuse could well be great in small corporations. In short, the advantages of redeemable common seem incommensurate with the risks both to the corporation, its creditors, and other shareholders.

Secondly, South Carolina forbids shares redeemable at the option of the shareholders.[213] The risks are related although different in an important respect. Here, the financial integrity of the corporation is exposed, in large measure, to the action of persons not carrying the responsibilities, legal and economic, of management; and since the interest of the shareholder in hard times is naturally to cut his loss, his option to bail out could greatly damage the financial, especially the cash, position of the corporation in a time when it probably needs to marshal and conserve its resources. Once again. the risk of injury to the corporation, and to the public and creditor interest in financially sound enterprises, would seem

211. S. C. §5.18(b)(1). The exception for mutual funds recognizes both business practicalities and the SEC supervision and mandatory disclosure provided in the Investment Company Act of 1940.

212. MODEL ACT §60; S. C. 5.18(c). Both statutes guarantee maintenance of net assets equal to the liquidation preferences of certain shares. shares.

213. S. C. §5.18 (b) (2).

to outweigh a corporation's theoretical interest in being free to issue such shares.

On the surface, it would seem that these prohibitions could be nullified by the corporation's undoubted right (in America) to repurchase its own shares. This argument is not persuasive. Both the Model Act and South Carolina set forth fairly rigorous requirements for the corporation to repurchase its own shares, confining it to unreserved and unrestricted earned surplus, or capital surplus if authorized by the articles or a two-thirds shareholder vote; stated capital is available only in the most limited circumstances.[214] The criterion in itself contrasts sharply with the insolvency limitation alone governing redemptions. Moreover, it would seem that the statutory power to repurchase shares will fulfill every legitimate need for redeemable common shares or shares (of any sort) redeemable at the option of the shareholder.

2. *Fractional Shares and Scrip*: Both South Carolina and the Model Act authorize fractional shares or scrip. Thus, under Model Act section 22, a corporation may, but need not, issue a fractional share certificate or alternatively may issue scrip. South Carolina is more restrictive on the right to have fractional shares, but more liberal on alternative means of treating them.[215] The premise here is that share fractions have no real *raison d'etre* other than as the residue of stock splits and stock dividends; and that the legitimate purposes which fractional shares might serve can just as well be handled through other techniques with little inconvenience and less risk to the corporation. Thus an unqualified right to issue share fractions represented by certificates entitling the holder to vote and receive dividends, is questionable. Under both the Model Act and the South Carolina law, a corporation may use resources other than earned or capital surplus to "eliminat[e] fractional shares,"[216] thereby making possible redemption of shares out of capital. Indeed, nothing seemingly bans a corporation from treating all of its shares as fractions of a larger denomination, and therefore subject to re-

214. S. C. §5.17; MODEL ACT §5. Corporation law revisions should probably also include a provision permitting repurchase, especially by small corporations, of shares on buy-out and option agreements, especially on death, withdrawal, etc., of shareholders. Compare the somewhat unsatisfactory efforts in this direction in N. C. GEN. STAT. §55-52(b)(4)(1960); OHIO REV. CODE ANN. §1701.35(A)(5) is superior.

215. S. C. §5.11.

216. MODEL ACT §5; S. C. §5.17(d)(1).

purchase out of capital. Foreclosing this risk and recognizing no real reason to encourage fractional shares, South Carolina requires share fractions to be aggregated into whole shares and then provides that only fractions "remaining after such aggregation" have the privileges of fractional shares.[217]

Besides allowing a corporation to issue scrip (as does the Model Act), South Carolina also permits corporations to "pay in cash the fair value of fractions of shares as of the time when those entitled to receive such fractions are determined." This should be of special interest to larger corporations, giving it the alternative of issuing scrip or paying cash for share fractions.

3. *Subscriptions*: Broadly following Model Act section 16, the South Carolina law extends the statutory benefit of irrevocability both to post-incorporation and pre-incorporation subscriptions (to which the Model Act provision is confined).[218] Secondly, as in many other states, all subscriptions must be in writing and signed by the subscriber; absent statute a subscription agreement may be oral. Apart from the wisdom generally of reducing serious agreements to writing, it is also desirable since the Uniform Securties Act, like the Securties Act of 1933,[219] defines "security" to include "any preorganization certificate or subscription," and thereby subjecting it to the registration requirements of the act. The transaction exemption for subscriptions is lost if anyone is paid for soliciting subscriptions, if there are more than ten subscriptions, or if any subscriber makes the payment on the subscription;[220] and a transaction in violation of the act creates, of course, substantial civil liabilities.[221] Since subscriptions fall within the scope of the most frequently adopted securities statute in this country, it would be well, therefore, if all subscriptions were reduced to writing.

4. *Preferred Shares*: *Rules of Construction*: An innovation in American corporation law is the South Carolina provision setting forth certain presumptions as to the rights of preferred shares.[222] Thus, preferred shares are presumed cumulative but not participating as to dividends, and also

217. S. C. §5.11(a).
218. MODEL ACT §16; S. C. §5.5.
219. Uniform Securities Act §401(1); Securities Act of 1933, §2(1).
220. *Id.* §402(b)(10).
221. *Id.* §410.
222. S. C. §5.4.

preferred on liquidation to their par or stated value; a liquidation preference is presumed exclusive without further participation, except for cumulative preferred which is presumed entitled on liquidation to be paid the accrued dividends. Finally, all preferred shares are presumed disfranchised (except as the statute otherwise allows).

This sort of provision can serve, it is believed, several useful purposes. First, it states summarily the result of much sound American case law. By and large, these rules fairly reflect what corporations normally intend to give, and what investors normally expect to receive, in a preferred share. Secondly, it removes uncertainty. The alternative to such a statutory guidepost is searching a large body of case law—some of which is conflicting as to rule, and much of which turns upon the precise (or more likely, imprecise or nonexistent) language of the preferred shares in the particular case. Thirdly, besides serving as a sort of check-list for the more usual, if not the more sophisticated, issues, it seems a matter which lends itself a codification without inhibition since all of the rules are expressly subject to variation by the terms of the preferred shares contract.[223]

B. *Dividends and Other Distributions*

With two exceptions, South Carolina and the Model Act agree on treating dividends, the key provision in both statutes limiting dividends to "unrestricted and unreserved earned surplus," subject, of course, to distributions out of capital surplus if protective procedures are followed. More basic, as already noted, the South Carolina statute in following the Model Act, makes the far-reaching decision to introduce important accounting concepts into the law. Finally, an important issue in this area is whether to give management maxi-

223. Two other minor provisions are worth noting. (1) Taking its cue from MODEL ACT §18, which prohibits "promissory notes" or "future services" as payment for shares, S. C. §5.7(b) seeks fuller coverage by providing that "[n]either promissory notes nor other obligations, including any endorsement or guaranty of an obligation of the corporation" nor "any agreement to perform future services," is legal payment. (2) S. C. §5.8, while following MODEL ACT §18A in authorizing broadly the issue of stock options, specifically requires that they are to be issued only "as an incentive to service or continued service to the corporation, a subsidiary or affiliate," thereby codifying some sound decisions from Delaware and elsewhere. This provision should afford some guidance to courts in a difficult area for which breach-of-duty concepts are crude tools; it would also seem superior to efforts, as in N. C. GEN. STAT. §55-45(b) (1960), to prescribe detailed limits on the value, etc., of the options.

mum freedom in declaring dividends, including the control of the earned surplus account, or to provde by statute some minimum guarantee of dividend payments, as in North Carolina. Apart from the unavoidable complexity of such protective devices, the South Carolina revision assumes that fraudulent or dishonest withholding of dividends, to squeeze out minority interests—the usual cause of abuse in this area—could better be handled by the courts as a breach of duty.

1. *Unrealized Appreciation*: A basic difference between the Model Act and South Carolina is the latter's prohibition against writing-up the earned surplus account (the prime dividends source) with unrealized asset appreciation.[224] Absent such a prohibition, there's a measurable chance that under an earned surplus test, assets could be written up from their cost basis and dividends paid out of this increase.[225] Indeed, one of the Model Act draftsmen asserts that the Model Act does permit such a write-up,[226] although another member of the Committee on Corporate Laws has argued that it should be available only for share, but not for cash or property, dividends.[227]

It was believed that the risk of dividends out of such an artificial source would exceed whatever gain might accrue from management "flexibility" or "freedom" on this matter. Indeed, it was thought affirmatively desirable to prescribe such a practice. Otherwise, corporations are apt to assume that they may pay dividends out of what is essentially a bookkeeping entry. Moreover, it is difficult to see how an unrealized increase in the value of an asset can logically be deemed a part of *earned* surplus (the retained *earnings* or retained *income* account), and indeed accountants believe that such a write-up is contrary to sound accounting practice. Again, a write-up of assets followed by dividend payments may have detrimental effects on the corporation's financial condition not known or clearly understood until bankruptcy

224. As in the Model Act, dividends are payable out of "unreserved and unrestricted earned surplus" (S. C. §5.14(a)(1)), but earned surplus is defined to exclude unrealized appreciation (S. C. §1.2(q)).

225. *Compare* Randall v. Bailey, 23 N. Y. S. 2d 173 (S. C. 1940), *aff'd*, 288 N. Y. 280, 43 N. E. 2d 43 (1942), overruled by N. Y. BUS. CORP. LAW §102(a)(6), *with* Berks Broadcasting Co. v. Craumer, 356 Pa. 620, 52 A. 2d 571 (1957).

226. Seward, *Earned Surplus—Its Meaning and Use in the Model Business Corporation Act*, 38 VA. L. REV. 435, 440-43 (1952).

227. Garrett, *Capital and Surplus under the New Corporation Statutes*, 23 LAW & CONTEMP. PROB. 239, 259 (1958).

or some other problem with creditors. Write-ups plus dividends may dissipate the margin of safety for creditors or preferred shareholders, even though the distributions might themselves not cause the corporation to become insolvent. If asset values fluctuate, the asset which cost $X and is written up to $X+$100 may be worth only $+$50 several years later (even allowing for depreciation), and yet the earned surplus account remains swollen unless written down to reflect the value decrease. Again, the level to which assets are to be written up involves an element of judgment, including misjudgment, negligent or deliberate, which may injure creditors and shareholders. Finally, the permission is a needless temptation to unscrupulous individuals to write-up share values, distribute dividends, and thereby promote a misleading picture of corporate prosperity, to the detriment of creditors, investors, and the corporation.

The South Carolina revisers believed that the arguments against unrealized appreciation tipped the balance decisively towards a clear cut prohibition against including it in earned surplus. Although it might be argued that a statute should be concerned only with the "legality" rather than the "advisability" of such a dividend source, it is nonetheless true that the advisability of a practice potentially affecting the soundness of corporations is, or should be, a dominant factor in choosing a rule of law for a new statute.

2. *Accounting Treatment of Treasury Shares*: The considerable attention paid to the accounting treatment of treasury shares is in inverse proportion to its importance, but is a favorite topic of argument perhaps because of its somewhat esoteric appeal. South Carolina abandons the Model Act's treatment by which earned surplus is restricted while shares are held in the "treasury," and the restriction removed on disposition or cancellation of shares.[228] Rather, the new statute proceeds forthrightly to provide that on acquisition, earned surplus is "reduced" by cost of the shares; that on sale, the consideration is capital surplus or, at the corporation's option, earned surplus to the amount of the original reduction; that stated capital is unaffected whether the shares

228. The South Carolina revision was much influenced by the discussion by Hackney, *The Financial Provisions of the Model Business Corporation Act*, 70 HARV. L. REV. 1357, 1393-1402 (1957) and Rudolph, *Accounting for Treasury Shares Under the Model Business Corporation Act*, 73 HARV. L. REV. 323 (1959), both critical of the Model Act "restriction" technique.

are retained or sold,[229] and that distribution to shareholders does not require any transfer to stated capital (as does a share dividend),[230] although, of course, the reduction of earned surplus becomes permanent. This procedure seems most consistent with the basic premise that treasury shares are a part of issued, although not outstanding, shares;[231] that they therefore remain a part of the corporation's stated capital;[232] and that the acquisition of treasury shares does not represent any contraction of stated capital.

X. CLOSELY HELD CORPORATIONS

The South Carolina law follows the current fashion in specially considering the close corporation. This is no fad, but a belated recognition that the greatest number of American corporations are in this category. Indeed, American law is now doing no more than catching up with England which long ago recognized for special treatment "private companies,"[233] which are in some ways equivalent to American close corporations. South Carolina statute goes probably further than any other state in specially providing for close corporations. The Model Act contains some provisions specially pertinent here, but omits others that are certainly needed.

South Carolina rejected a special statute for close corporations, for reasons already noted earlier in this article, and instead merely inserted in the general corporate law certain specific provisions. This seems appropriate at this stage of our knowledge of the needs, both business and legal, of the close corporation; although in the future it may be possible to draft a separate statute, this should come about as the culmination of a long process of study and especially of judicial decision—like the Uniform Partnership Act which crowned centuries of case law development. In all events, whatever the future, the current technique is to fashion special provisions for the close corporation; some of them are intrinsically inapplicable to larger corporations, while others are specifically limited to close corporations.

229. S. C. §5.17(c).
230. S. C. §5.15(a)(2).
231. S. C. §1.2(k); MODEL ACT §2(h).
232. S. C. §1.2(l); MODEL ACT §2(j).
233. Companies Act, 1948, 11 and 12 Geo. VI, c. 38, §28.

Most of the provisions which bear upon the interests of the closely held corporation have been discussed already, and need only cursory mention here. They include, like the Model Act, superstatutory voting and quorum requirements, which cannot be amended out except by the vote which is to be protected. Similarly applicable are sections which validate informal shareholder and director action. Of particular importance to small enterprises are various shareholder control devices including those enabling the shareholders to manage the day-to-day business of the corporation. Other relevant provisions authorize the shareholders directly to elect and remove officers; proportion the number of directors to the number of shareholders when there are fewer than three shareholders; and fix consideration on the issue of shares. Similarly useful is the authorization of dissolution options for a particular shareholder or class or number of shareholders; and broad court jurisdiction to dissolve a corporation on petition of a shareholder, and the judicial relief alternative to dissolution.

XI. FOREIGN CORPORATIONS

The South Carolina law closely follows the Model Act on foreign corporations. Indeed, many of the same considerations which call for uniformity on state securities regulations are applicable here, in order to meet the requirements of corporations doing a multi-state business, and therefore wishing to qualify in several states.

On serving process on foreign corporations, South Carolina adds to the standard provision (which appears in the Model Act[234]) for process service on authorized foreign corporations, a desirable procedure for reaching unauthorized foreign corporations which either have an exemption from qualification or have wilfully or negligently failed to qualify.[235] Thus, "every foreign corporation which is not authorized to do business in this state shall, by doing in this state, either itself or through an agent, any business, including any business for which authority need not be obtained" be deemed to have designated the Secretary of State as its agent to receive service of process. Such a provision is ob-

234. MODEL ACT §108; S. C. §13.13.
235. S. C. §13.14; See N. Y. BUS. CORP. LAW §307. This continues prior statute law (S. C. CODE §10-424 (1952)).

viously constitutional under Supreme Court decisions sustaining constructive designation of the Secretary of State as an agent for process service in *in personam* actions.[236] The statute also makes it clear that this constructive designation is effected even though the foreign corporation under the statute need not secure authority in this state. Similarly, after specifying the business for which a foreign corporation needs no authorization, section 13.1(c) specifies that these exemptions "shall not be deemed to establish a standard for activities which may subject a foreign corporation to service or process."[237] The standards are and should be different. For example, there is good reason not to require authority for a foreign concern to carry through an isolated business transaction in the state, but that is no reason to immunize it from suit on a right arising out of the transaction. Similarly, control of a subsidiary does not require the parent corporation to qualify,[238] but the parent's control may well be sure that it has made itself emenable to service of process because the subsidiary is the parent's "agent." Absent this qualifying clause, it is arguable that exemption from authorization may also be determinative of the validity of process served on the unauthorized foreign corporation.

Conclusion

This article has attempted to show not only South Carolina's indebtedness to the Model Act, but also some of the reasons prompting departures from the Model Act or, in the more usual case, inducing the South Carolina revisers to include additional provisions. No corporation law can expect to achieve complete coverage. Therefore, the most important means of keeping a corporation law workable and modern is to keep a constant eye, as do the Model Act draftsmen, upon the constantly developing problems in the field and the decisions; and to institutionalize this oversight through a standing committee—a program which, it is hoped, can be inaugurated in South Carolina and which would seem desirable in any state keenly interested in the legal problems of doing business in the corporate form.

236. *E.g.*, Hess v. Pawloski, 274 U. S. 353 (1927).
237. Adapted from N. Y. BUS. CORP. LAW §1301(c).
238. S. C. §13.1(b)(8).