CURRENT LEGISLATION

CORPORATIONS

MASSACHUSETTS CORPORATE PROVISIONS

Over a century ago, Chief Justice Shaw said, "The State of Massachusetts is eminently a community of corporations."[1] In an attempt to preserve the state as a "community of corporations" the Massachusetts legislature enacted a new business corporations statute, Chapter 156B,[2] which consolidates, revises, and replaces the present business corporations statutes.[3] The drafting committee on corporate law of the Boston Bar Association, in drawing up the new statute used the ABA-ALI Model Business Corporation Statute (hereafter cited as the Model Act) as a guide.[4]

The general purpose of the Model Business Corporation Act is to provide a statute on general business corporations which might be of assistance and use to any state which desires to rewrite and modernize its basic corporation laws. The act was not designed for adoption in its entirety. "It was realized that there would be, in every state, local preference, and traditions, or constitutional provisions, which would dictate departures."[5] Generally, the Model Act attempts to preserve in proper balance the interests of the public, corporations, shareholders, and management. Jurisdictions adhering to the Model Act with more or less minor variations include Wisconsin, Oregon, District of Columbia, Texas, Virginia, North Dakota, Alaska, Colorado, and Iowa. Similar to the Model Act in many respects are the statutes in Maryland, Illinois, Puerto Rico, and Alabama.[6]

The purpose here is to survey some of the highlights of the new Massachusetts business corporations statute (hereafter referred to as new act) and to attempt to point out the reasons for the adopted alterations. More specifically, attention will be focused upon alterations in substantive rights and powers. In addition, some comparative reference will be made to the Model Act.

While shareholders are the owners of a corporation, the general powers of management do not reside in them, but in the board of directors. The shareholders' most important control over management lies in the election of directors, and shareholders can best influence management policy by electing directors with similar predilections. Co-ordinate with this power of election is the removal of directors. The present corporation statute, chapter 156, section 22 of the Mass. Gen. Laws Ann., makes provisions for the election of directors and officers by shareholders but makes no provision for the removal of directors and officers by shareholders. Ap-

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1 Godard v. Smithett, 69 Mass. (3 Gray) 116, 117 (1854).

2 Mass. Acts 1964, ch. 723 §§ 1-114 (effective October 1, 1965).

3 Mass. Gen. Laws Ann. ch. 155, §§ 1-56; ch. 156, §§ 1-55 (1958).

4 ABA-ALI Model Bus. Corp. Act §§ 1-145 (1960).

5 Campbell, The Model Business Corporation Act, 11 Bus. Law 98 (1956).

6 See Brown, A Consideration of the Nebraska Corporation Law in the Light of the American Bar Association's Model Business Corporations Act, 39 Neb. L. Rev. 575, 577, n.10 (1960).

proximately one-half of the states have no statutory provision for the removal of directors.[7] It is generally stated that shareholders have inherent authority to remove directors from office, if cause can be shown.[8] Such authority is necessary since, otherwise, a director who is guilty of continuing violations of his duty could remain in office.

There is no implied power in the shareholders to remove the directors without cause before the expiration of their term.[9] As a result, the shareholders, although the owners of the corporation, must acquiesce in the policies of the directors in control, even though these policies do not represent majority shareholder opinion. The new act provides that directors and officers elected by stockholders may be removed with or without cause by a majority vote of shareholders entitled to vote.[10] Since Massachusetts allows the division of directors into classes,[11] chapter 156B, section 51 provides that directors elected by a particular class of shareholders may be removed only by the majority vote of that class. The Model Act permits removal of directors with or without cause by the stockholders.[12]

It would appear that the new "removal" provision will be an important safeguard and means of control for the majority shareholders. If directors have a right to continue in office until the completion of their term, in spite of a change in controlling shareholders, those who acquire control will have to wait until the annual meeting or else convince the present directors to resign and put in office a new board of directors representing their views of policy. A majority of shareholders will now be able to remove directors, without waiting until the next annual meeting, and appoint new directors to carry out their business policy. It would appear that as a matter of corporation law the new "removal" provision in effect transfers directorial control from fiduciary directors to the majority stockholders and results in a partnership type control.

In addition, chapter 156B, section 51 provides that officers appointed by the directors may be removed with or without cause by a majority vote of the directors then in office. The present corporation act of Massachusetts makes no provision for such officer removal. Generally, most jurisdictions hold that directors have the power to elect or appoint officers and have the power to remove officers with or without cause.[13] The object of this new provision is apparently to give the fullest control and responsibility to the directors in managing corporate affairs. If an officer under an employment contract may be removed without cause, then his removal may be a breach

7 See generally I CCH Corp. Law Guide ¶ 668.

8 E.g., Norman v. Roosevelt Democratic Club, 17 Misc. 2d 219, 220, 184 N.Y.S.2d 980 (1959). Auer v. Dressel, 306 N.Y. 427, 432, 118 N.E.2d 590, 593 (1954). 2 Fletcher's Cyclopedia Corporations § 356 (perm. ed. 1954).

9 Abberger v. Kulp, 156 Misc. 210, 212, 281 N.Y. Supp. 373, 376 (1935). Ballantine, Corporations § 185, at 434 (Rev. ed. 1946).

10 Mass. Gen. Laws Ann. ch. 156B, § 51 (Supp. 1964).

11 Old statute—Mass. Gen. Laws Ann. ch. 156, § 22 (1958). New statute—Mass. Gen. Laws Ann. ch. 156B, § 50 (Supp. 1964).

12 ABA-ALI Model Bus. Corp. Act § 36A (1960) (optional section).

13 See, e.g., Casson v. Bossman, 137 N.J. Eq. 532, 45 A.2d 807 (1946); Cuppy v. Stallwerck Bros., 216 N.Y. 591, 111 N.E. 249 (1916).

of contract, rendering the corporation liable in damages.[14] If a valid employment contract exists between the corporation and officer, then the board may be said to have the power but not the right to remove and the corporation will be liable for damages. This is the view adopted by the Model Act.[15]

Section 51 of the new act also provides that "directors and officers elected by shareholders may be removed for cause by a majority vote of the directors then in office."[16] This is a completely new provision to Massachusetts corporate law. Generally, the board of directors has no power to remove a fellow director for cause, even though it believes him hostile to the corporation, as the director is chosen by the shareholders.[17] The Model Act contains no provision for the removal of directors by fellow directors.

The new act requires that a minority shareholder who seeks to institute a derivative suit must have been a shareholder at the time of the act complained of, or have obtained his stock by operation of law from one who was a stockholder at such time.[18] This is generally referred to as the "contemporaneous ownership requirement" and is perhaps the most important qualification placed upon a plaintiff–shareholder in a derivative suit.[19] The prior Massachusetts corporation statute was silent on this point. Case law explicitly eliminated such a requirement.[20] In substance, the corporation is the plaintiff, and the shareholder merely sets the judicial machinery in motion to enforce a corporate cause of action. Any recovery inures to the benefit of the corporation.[21] On the other hand, a direct suit (suit in his own right) involves the enforcement by a shareholder of a cause of action against directors or majority shareholders for wrongful acts which result in direct injury to the shareholder.[22]

Derivative suits are a very valuable remedy as a means of holding wrongdoers to account, but the remedy itself is subject to abuse when

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14 Cf. Buswell Trimmer Co. v. Coburn, 188 Mass. 254, 74 N.E. 334 (1905).

15 ABA-ALI Model Bus. Corp. Act § 45 (1960); Accord, United Producers and Consumers Co-op v. Held, 225 F.2d 615 (9th Cir. 1955).

16 Directors, treasurers and clerks are elected by shareholders. Mass. Gen. Laws Ann. ch. 156B, § 48 (Supp. 1964).

17 See Bruch v. Nat'l Guar. Credit Corp., 13 Del. Ch. 180, 116 Atl. 738, 741 (1922). (Only the appointing authority has removal authority.) Compare Frank v. Anthony, 107 So. 2d 136 (Fla. 1958); Brindley v. Walker, 221 Pa. 287, 70 Atl. 794 (1908).

18 Mass. Gen. Laws Ann. ch. 156B, § 46 (Supp. 1964).

19 Arizona, Colorado, Georgia, Kentucky, Missouri, Nevada, New Jersey, New Mexico, New York, North Dakota, Oklahoma, Washington, the District of Columbia and Puerto Rico provide that in a shareholder derivative action the plaintiff must have owned his shares at the time of the transaction complained of or have acquired them by operation of law. ABA-ALI Model Bus. Corp. Act § 43A, comment 2.202(1) (1960).

20 Peterson v. Hopson, 306 Mass. 597, 611-12, 29 N.E.2d 140, 149 (1940) held that:

> It is no objection to the bill that the plaintiff is not alleged to have been the owner of preferred stock at the time of the alleged wrongdoing. . . . [I]t is immaterial whether the stockholder who seeks to vindicate the right of the corporation was such at the time of the wrongdoing or not.

21 See generally Ballantine, Corporations § 143 (Rev. ed. 1946).

22 See, e.g., Zahn v. Transamerica Corp., 162 F.2d 36 (3d Cir. 1947); Lebold v. Inland Steel Co., 125 F.2d 369 (7th Cir. 1941).

brought by small shareholders primarily to enrich themselves. The purpose of the "contemporaneous ownership requirement" is to prevent the buying of nuisance or strike suits.[23] A strike suit has been defined as "an action brought purely for its nuisance value, with the purpose of obtaining a settlement for the complainant's sole benefit—the amount of the proposed settlement being far greater than any possible injury suffered by the complainant."[24] Nuisance suits, strike suits, and other abuses of the derivative remedy have led to various restrictions being placed upon it.[25] It would appear that Massachusetts adopted this provision to prevent a subsequent purchaser of shares from speculating in a purchased cause of action.

As a general rule, if a minority shareholder satisfies the "contemporaneous ownership requirement," a court will not consider his wrongful motives unless he is suing solely in the interests of an adverse company, in which case the action will be dismissed.[26] Therefore, it would seem that no adequate rule has been enacted to prevent a shareholder who satisfies the "contemporaneous ownership requirement" from bringing a strike suit.[27]

The "contemporaneous ownership" provision is indicative of an attempt by Massachusetts to get in line with modern corporate law by striking a balance between the need for derivative suits and the abuses to which such suits are subject.

The appraisal remedy of a dissenting shareholder has been substantively and procedurally revised. The appraisal remedy is one which permits dissenting minority shareholders to demand that the corporation purchase the shareholder's stock. The purpose of such a provision is to grant dissenters a simple and efficient means of withdrawing from the corporation in case of fundamental changes.[28]

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23 See generally, ABA-ALI Model Bus. Corp. Act § 43A, comment (1960).

24 Ballantine, Corporations § 149, at 354-56 (Rev. ed. 1946).

25 The original rule was set out in Hawes v. Oakland, 104 U.S. 450 (1881). The complaint in a shareholder's derivative suit must allege besides his efforts to obtain redress from the directors and shareholders that the plaintiff was a shareholder at the time of the transaction complained of, or that his shares came to him since then by operation of law, and that the action is not one to get the case into a federal court on the ground of diversity of citizenship. This rule later became Fed. R. Civ. P. 23(b). Fed. R. Civ. P. 23(c) prohibits dismissal or compromise without court approval, with such notice to other shareholders as the court may direct.

26 See, e.g., Quirke v. St. Louis-San Francisco Ry., 277 F.2d 705 (8th Cir. 1960); Ballantine, Corporations § 149, at 354-56 (Rev. ed. 1946).

27 The ABA Model Act which was a pattern for the new Massachusetts business corporation statute contains a "contemporaneous ownership requirement." In addition, the ABA Model Act contains a provision whereby the court in a shareholder derivative action, found to have been brought without reasonable cause, may require the plaintiff to pay the defendants the reasonable expenses, including attorney's fees, incurred in the defense of the action; and a security for expenses provision (the holder or holders of less than 5% of the outstanding shares of a class, unless the market value of such shares is $25,000, shall be required to give security for expenses). ABA-ALI Model Bus. Corp. Act § 43A (1960) (optional section). Such a rule would seem to be a strong deterrent to a "contemporaneous shareholder" who lacks reasonable grounds, from bringing a strike suit.

28 See generally, Looney, Dissenting Minority Stockholder's Right of Appraisal, 4 B.C. Ind. & Com. L. Rev. 85 (1962); Moynihan, Dissenting Stockholder's Remedy

Massachusetts early enacted such an "appraisal statute" which met with the favor of other legislatures to such an extent that it was adopted either verbatim or in substance in nine other states.[29] The old appraisal statute permits a right of demand and payment upon a sale, lease or exchange of all or substantially all the corporation's property and assets, or for a change in the nature of its business,[30] or if the corporation has voted to merge or consolidate.[31] The new act eliminates the appraisal remedy for a change in the nature of the corporation's business, retains the remedy if the corporation has voted to sell, lease or exchange all or substantially all its assets,[32] or if the corporation has voted to merge or consolidate[33] and extends the remedy for any amendment of the articles of organization which adversely affects the rights of the stockholders.[34]

Under the old act, chapter 156, sections 41, 41A, 41B, and 41C control transactions relating to stock provided that no amendment impairing or diminishing the preferences, voting powers, restrictions and qualifications of any class of stock may be passed without the consent of the holders of such stock. For example, under the old act if a majority votes to abolish preferences, and a minority does not consent to such a change, the minority may retain its preferences, although the majority has eliminated its own preferences.[35] In such a situation there would be no right of appraisal, and it would appear that the minority has, for all practical purposes, a veto power over a proposed amendment which would "impair or diminish the preferences, voting powers, restrictions or qualifications of the stock held by him."

Applying the new act, in the example given above, if a majority eliminated preferences, the minority would have to resort to the appraisal remedy. The new provision affords every dissenting minority shareholder "adversely affected" the protection afforded by the appraisal remedy[36] and eliminates the minority shareholder's virtual veto power by permitting changes of the stock provisions of the articles of organization which "adversely affect shareholder rights" by a two-thirds vote.[37]

The Model Act permits the appraisal remedy in case of merger or

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upon Consolidation, 7 Ann. Survey of Mass. Law 56 (1960); Comment, 72 Harv. L. Rev. 1132 (1959).

[29] Colorado, Connecticut, Georgia, Idaho, Indiana, Minnesota, New Hampshire, Vermont, Wyoming. See Kaplan, Problems in the Acquisition of Shares of Dissenting Minorities, 34 B.U.L. Rev. 291, 292 (1954).

[30] Mass. Gen. Laws Ann. ch. 156, § 46 (1958).

[31] Mass. Gen. Laws Ann. ch. 156, § 46E (1958).

[32] Mass. Gen. Laws Ann. ch. 156B, § 76 (Supp. 1964).

[33] Mass. Gen. Laws Ann. ch. 156B, § 85 (Supp. 1964).

[34] Mass. Gen. Laws Ann. ch. 156B, § 77 (Supp. 1964).

[35] See James v. Washburn Co., 326 Mass. 356, 94 N.E.2d 479 (1950). It was held that, although a recapitalization plan authorized cancellation of all preferred and common stock, and substitution of capital stock thereof was adopted by vote of more than two-thirds of each class of stock outstanding, a dissenting preferred stockholder had the right to retain liquidation dividend, voting and other preferences attached to her stock. The corporation could not cancel all existing preferred and common shares in existence at the time and could not take away preferences of such stock without consent of the individual shareholder.

[36] Mass. Gen. Laws Ann. ch. 156B, §§ 76, 77 (Supp. 1964).

[37] Mass. Gen. Laws Ann. ch. 156B, § 74 (Supp. 1964).

consolidation, or upon any sale or exchange of all or substantially all of the assets of the corporation, not made in the regular course of its business.[38] The Model Act provides no appraisal right as a result of the lease, mortgage or pledge (as distinguished from a sale or exchange) of all, or substantially all, of the corporate assets, or in the case of amendment of the articles of organization. Both Massachusetts and the Model Act do not allow the appraisal remedy in case of a merger of a parent corporation with a wholly owned subsidiary.[39] It would appear that in such a merger the change is formal only, the shareholder's essential position is unchanged, and there is no logical reason for granting appraisal rights.

Under the old act, in order to perfect his appraisal rights, the shareholder must have voted against the action taken, and within thirty days of the vote made a written demand that the corporation purchase his stock. If the corporation and shareholder cannot agree upon the value of the stock, then such value will be determined by three disinterested appraisers, one each appointed by the shareholder and corporation and the third chosen by both. The finding of the appraisers is final and if the corporation does not pay in thirty days, the shareholder may sue in contract for the appraised value.[40]

The procedure of the new act is as follows: in order to preserve rights, the shareholder must file a written objection with the corporation before the proposed vote and must ***not have voted in favor*** of the proposed action. Within ten days of the effective date of the voted matter, the corporation must notify each stockholder (who has made a demand and not voted in favor) by registered mail that the action approved at the meeting has become effective. If the shareholder makes a demand within twenty days, then the corporation must pay him the fair value of his stock within thirty days of receiving notice. If they fail to agree on the fair value during the thirty days, then within four months either may bring a bill in equity in superior court in the county where the corporation has its principal office in this state, demanding a determination of value. Any bill filed must state the names of all the stockholders who have demanded payment and with whom the corporation has not reached agreement; thus it will be a consolidated proceeding. Notice of the proceeding shall be given to all such stockholders. After a hearing, the court shall determine value and in addition may impose costs, exclusive of fees of counsel or other appraisal experts, including the reasonable compensation of any master appointed by the court and interest shall be granted from the date of the award.[41]

The appraisal procedure of the new act is more lengthy and complex than under the prior act, but it would appear that such considerations are overridden by the exactitude and fairness of the provisions. The procedure of the old act created more problems than it solved. There were no pro-

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[38] ABA-ALI Model Bus. Corp. Act § 73 (1960).

[39] ABA-ALI Model Bus. Corp. Act § 73 (1960); Mass. Gen. Laws ch. 156B, § 85 (Supp. 1964).

[40] Mass. Gen. Laws Ann. ch. 156, § 46 (1958).

[41] Mass. Gen. Laws Ann. ch. 156B, §§ 87-98 (Supp. 1964).

cedures for resolving appraiser conflicts[42] or for determining costs,[43] and there was no provision for consolidating appraisal hearings. It would appear that if more than one shareholder sought to enforce appraisal rights, there would be a necessity for multi-appraisal proceedings, and there was the possibility that the value determined in each case would be different because the choice of the appraiser was left to the parties. Neither statute provides a basis for the determination of "fair value" and it would appear that such must ultimately depend upon the circumstances of each case.[44]

The new act provides that the appraisal remedy is the dissenting shareholders' exclusive remedy, except that it does not preclude the shareholder from bringing an action for fraud or illegality.[45] It would appear that "exclusive" indicates that the shareholder will be prevented from enjoining corporate action on grounds of unfairness or harshness.[46] It is submitted that the elimination of suits for unfairness or harshness would protect the corporation from defending against vexatious suits by the minority who disagree with policy changes. Since majority vote controls, common sense would require that minority shareholders absent fraud or illegality should not be permitted to prevent organizational changes. The old act and the Model Act are silent on this point.

It would appear that many legal headaches will be avoided by the new act which slightly varies the Model Act appraisal remedy.[47] The Model Act not only requires the corporation to send a written notice after approval of the action, but requires it to make an offer of settlement and to enclose a balance sheet and a profit or loss statement. It would appear that such additional financial information is for the shareholder's benefit in determining the value of his shares.

The new business corporations act, in addition to substantive changes, contains many new provisions which, when taken as a whole, evidence a desire to modernize, and to liberalize procedural requirements so as to provide more flexibility in corporate operations.[48] For example, chapter 156B, section 9 of the new act enlarges the statutory powers possessed by a corporation. Under the new act the mere act of incorporation, no matter

42 For a discussion of appraiser difficulties which may arise under the statute, see Kaplan, supra note 29.

43 For a discussion of the problem of the allocation of expenses of appraisal, see Comment, 60 Yale L.J. 337 (1951).

44 For a discussion of problems of valuation, see Moynihan, supra note 28.

45 Mass. Gen. Laws Ann. ch. 156B, § 98 (Supp. 1964). In Cole v. Wells, 224 Mass. 504, 113 N.E. 189 (1916), it was held that the appraisal remedy is not exclusive but is an alternative if the shareholder is able to prove fraud or deceit.

46 See generally, Note, 69 Harv. L. Rev. 538, 545-51 (1956). "Fairness" is considered in the context of specific charter amendments, recognizing that the cumulative effect of all proposed changes is relevant.

47 ABA-ALI Model Bus. Corp. Act § 74 (1960).

48 The new act requires that only the articles of organization be filed. Mass. Gen. Laws Ann. ch. 156B, § 12 (Supp. 1964). The old act requires the articles of organization and agreement of association be filed before a certificate of incorporation will be issued. Mass. Gen. Laws Ann. ch. 156, § 11 (1958). The agreement of association has been eliminated in the new act. Such simplification avoids formalities and lessens paper work and filing requirements.

what the purpose of the corporation may be, automatically confers upon the corporation powers which might or might not be otherwise implied as a necessary power in furtherance of the corporate purpose.[49] Such a change will save paper work by making it unnecessary for lawyers to insert in the corporation papers the long standard forms of broad general powers. In addition, corporate flexibility is extended by chapter 156B, section 35 of the new act which permits shareholder meetings to be held beyond the territorial bounds of the state.[50]

Massachusetts in its new legislation has attempted to provide a more concise organization of the law relating to corporations. Its provisions are arranged in a more orderly manner facilitating locations of desired sections and interpretation. Procedurally, there have been adopted changes which consolidate unnecessary filing which has overburdened our department of corporations and have only hampered corporate filing requirements. Substantively, Massachusetts has fallen in line with the more modern corporate jurisdictions and is making its corporation laws attractive to possible incorporators so as to preserve Massachusetts as a "community of corporations."

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49 In the old act, the "powers sections" list only a few of the statutory powers needed by a corporation. Mass. Gen. Laws Ann. ch. 155, § 5, ch. 156, § 4 (1958). The inclusion of a comprehensive listing of the corporate powers will eliminate confusion and ambiguities involved in determining proper lines of corporate activity.

50 The new act, in accordance with this idea of flexibility, provides that the directors may act without a meeting if they unanimously assent in writing. Mass. Gen. Laws Ann. ch. 156B, § 59 (Supp. 1964). Under this provision, the directors are empowered to decide on corporate matters without waiting for a regular meeting or calling a special meeting.