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# Comment

## THE PROVISIONAL DIRECTOR STATUTE<sup>1</sup>

A relatively new and unusual cure for corporate deadlock is the court-appointed provisional director. Section 351.323, RSMo 1959 authorizes a court to appoint a provisional director at the instance of one-half of the directors or one-third of the shareholders where it is shown that an even number of directors is evenly divided and that the management of the corporation is adversely affected thereby. The statute sets forth the provisional director's qualifications and gives him all the rights and powers of an ordinary director until the deadlock is broken or he is removed by order of the court or by a majority of the voting shares. The ensuing commentary concerns the nature of this new remedy, its application to typical close corporations and the duties of a provisional director.

### A. *Function and Purpose of the Provisional Director*

The Missouri statute is substantially identical to California's provisional director statute.<sup>2</sup> The leading California case, *In re Jamison Steel Corp.*,<sup>3</sup> illustrates the function of a provisional director. The corporation had a four-man board of directors. Owing to continual tie-votes on the board, the management of the corporation had become stagnant. A provisional director was appointed.

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1. § 351.323, RSMo 1959 provides:

1. If a corporation has an even number of directors who are evenly divided and cannot agree as to the management of its affairs, so that its business cannot longer be conducted to advantage or so that there is danger that its property and business will be impaired and lost, the circuit court of the county where the principal office of the corporation is located may, notwithstanding any provisions of the articles or by-laws of the corporation and whether or not an action is pending for an involuntary winding up or dissolution of the corporation, appoint a provisional director pursuant to this section. Action for the appointment may be filed by one-half of the directors or by the holders of not less than thirty-three and one-third per cent of the outstanding shares.

2. The provisional director shall be an impartial person, who is neither a shareholder nor a creditor of the corporation, not related by consanguinity or affinity within the third degree to any of the other directors or officers of the corporation, or to any judge of the court by which he is appointed. The provisional director shall have all the rights and powers of a director, and shall be entitled to notice of the meetings of the board of directors and to vote at such meetings, until the deadlock in the board of directors is broken or until he is removed by order of the court or by vote or written consent of the holders of a majority of the voting shares. He shall be entitled to receive such compensation as may be agreed upon between him and the corporation, and in absence of such agreement he shall be entitled to such compensation as shall be fixed by the court.

2. CAL. CORP. CODE § 819.

3. 158 Cal. App.2d 27, 322 P.2d 246 (1958).

In *Jamison* the court viewed the appointment of a provisional director as a device to avoid commercial loss resulting from the board's inability to function effectively.<sup>4</sup> Cessation or diminution of operations is avoided and business is allowed to continue so long as there is a court-appointed director on the board.<sup>5</sup>

In lieu of petitioning for the appointment of a provisional director, a shareholder of a Missouri corporation with a deadlocked directorate may seek the appointment of a receiver pursuant to involuntary liquidation of its assets and business.<sup>6</sup> Such liquidation proceedings may be instituted whether or not the deadlock results from an even division of directors. Notwithstanding a pending action for liquidation, the provisional director may be appointed.<sup>7</sup> If the deadlock on the board is broken, the involuntary liquidation proceedings may be dismissed.<sup>8</sup> Should liquidation and dissolution become inevitable subsequent to the appointment of a provisional director, he probably may remain on the board.<sup>9</sup> This will enable the corporation to continue operations until a final determination is reached<sup>10</sup> and will avert the harmful appointment of a receiver *pendente lite*.<sup>11</sup>

If a receiver *pendente lite* is appointed and empowered to take control of the corporation pursuant to involuntary liquidation proceedings, the subsequent appointment of a provisional director would be futile; however, it is not likely that this situation will arise. Missouri courts refrain from appointing receivers and

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4. *Id.* at 36, 322 P.2d at 251.

5. The court appointed director, *sua sponte*, may request the court to dismiss him if he believes that the deadlock cannot be broken. *In re O'Brien Machinery, Inc.*, 224 Cal. App.2d 563, 36 Cal. Rep. 782 (1964), *In re Jamison*, *supra* note 3, at 40, 322 P.2d at 253. In the *O'Brien* case the provisional director remained on the board of the corporation for nearly one year. He asked the court to remove him because he felt that a more drastic remedy was needed to cure the dissension among the directors. Subsequent to his removal an action for liquidation and dissolution of the corporation was filed. The lower court's decree that the corporation be liquidated was affirmed in 224 Cal. App.2d 563, 36 Cal. Rep. 782.

6. Liquidation proceedings may be brought where it is made to appear that the directors are deadlocked and the shareholders are unable to break the deadlock and that irreparable injury is being suffered or threatened thereby. § 351.485 (1) 1 (a), RSMo 1959. A receiver *pendente lite* may be appointed to preserve the assets and carry on the business of the corporation during liquidation proceedings. § 351.490 (1), RSMo 1959. Liquidation instituted in this manner may be discontinued at any time during the proceedings if it appears that the deadlock in corporate affairs has been broken. § 351.505 (1), RSMo 1959.

7. See statute cited note 1 *supra*.

8. See note 6 *supra*.

9. See TINGLE, THE SHAREHOLDER'S REMEDY OF CORPORATE DISSOLUTION 135 (1959). The *O'Brien* case, *supra* note 5, did not hold that a provisional director *must* be dismissed by the court where the dissension cannot be eliminated.

10. In California, a court has discretionary power, by statute, to appoint a provisional director *during* proceedings for involuntary winding up and dissolution. § 4655 CAL. CORP. CODE, *Edlund v. Los Atlos Builders*, 106 Cal. App.2d 350, 235 P.2d 28 (1951).

11. The provisional director remedy is intended to avoid the adverse effect on corporate credit that normally attends the appointment of a receiver. *In re Jamison*, *supra* note 3, at 36, 322 P.2d at 250, TINGLE, *op. cit. supra* note 9, at 135.

liquidating the assets of a corporation unless there is no other adequate remedy.<sup>12</sup> The provisional director statute affords such a remedy.

### B. *The Hearing*

An action for the appointment of a provisional director is instituted in the circuit court of the county where the principal office of the corporation is located. In *Desert Club v. Superior Court*,<sup>13</sup> it was held that appointment of a provisional director requires a trial in the usual manner provided by law, and that the final determination is appealable.<sup>14</sup>

The sole issue in such a hearing is *whether* there is a deadlock, not why the deadlock exists. Neither the reason for a particular quarrel, the good faith of the parties, nor the doctrine of estoppel is relevant to the question before the court.<sup>15</sup> In view of the possibility for abuse<sup>16</sup> of this remedy, it has been suggested that a duty to deal fairly with both factions on the board be imposed on the provisional director.<sup>17</sup>

### C. *Application of Section 351.323*

At the hearing it must be shown that the corporation comes within the coverage of the provisional director statute. Several items of proof are necessary.

It must be shown that the corporation has "an even number of directors who are evenly divided and cannot agree as to the management of the corporation." This prerequisite apparently had its origin in statutes dealing with involuntary dissolution upon deadlock.<sup>18</sup>

In several cases it has been held that "an even number of directors" refers to the number of directors on the board as provided in the articles of incorporation

12. *Handlan v. Handlan*, 360 Mo. 1150, 232 S.W.2d 944 (1950), *Niedringhaus v. William E. Niedringhaus Inv. Co.*, 329 Mo. 84, 46 S.W.2d 828 (1931). *Accord, in re Jamison*, *supra* note 3, at 35, *Sternberg v. Wolff*, 56 N.J.Eq. 555, 42 Atl. 1078 (1898). See generally, TINGLE, *op. cit. supra* note 9, at 135.

13. 99 Cal. App.2d 346, 347, 221 P.2d 766 (1950).

14. *Ibid.*

15. *In re Jamison Steel Corp.*, 158 Cal. App.2d at 39, 322 P.2d at 252 (1958).

16. Since § 351.323, RSMo 1959 gives majority shareholders the power of removal, the provisional director might listen more attentively to the proposals of their representatives than to the other directors. If a court-appointed director were to side with the other directors on an important matter, he could be removed and a new provisional director petitioned for. The next court-appointed director might take a different stand on the matters in issue.

17. Comment, 48 CALIF. L. REV. at 280, n. 36.

18. At the time California enacted the precursor of the provisional director statute, N.Y. GEN. CORP. LAW § 103 allowed dissolution at the instance of the holders of one-half of the shares where it was shown that a corporation had "an even number of directors who are evenly divided respecting the management of its affairs. . . ." Currently section 103, as amended in 1944 and 1951, also allows dissolution where the shareholders cannot elect a board of directors or where, pursuant to high percentage vote requirements for director or shareholder action, the requisite number of votes for board action or for election of directors cannot be obtained. See also FLA. STAT. § 608.28 (1955); N.J. REV. STAT. § 14:13-15 (1937), UNIFORM BUSINESS CORPORATION ACT § 51.

or by-laws of the corporation.<sup>19</sup> Other courts have construed the phrase to mean there must be an even number of directors *in office* at the time of the deadlock.<sup>20</sup> Under this latter view vacant directorships are ignored. California seems to be in accord with this interpretation.<sup>21</sup> It has been suggested that vacant directorships which *can be filled* by appropriate shareholder or director action must be counted towards the number of directors on the board.<sup>22</sup> The corporation should be allowed the opportunity to cure the deadlock by electing or appointing an odd-man to the board before seeking judicial relief.

"An even number of directors" may be construed to refer only to those directors *functioning* as such; however, in the majority of the decisions alleged "dummy directors" have been treated as ordinary directors.<sup>23</sup> *Petition of Binder*<sup>24</sup> appears to be an exception. Petitioner there sought dissolution under a New York statute which applied only in the case of "an even number of directors who are evenly divided. . . ." One of the three directors of the corporation allegedly had

19. *In re* Roanoke Homes, Inc., 234 N.Y.S.2d 109 (Sup. Ct. 1962) (corporate charter providing for uneven board controlling where only two directors elected), *In re* Friedlieb, 184 N.Y.S. 753 (Sup. Ct. 1920).

20. *Dorf v. Hill Bus Co.*, 140 N.J.Eq. 444, 54 A.2d 761 (1947), *In re* Hi-Lite Plastics, 165 N.Y.S.2d 888 (Sup. Ct. 1947). In the *Dorf* case the articles of incorporation provided for a board consisting of four directors. After one of the four died the shareholders were unable to elect a successor. Dissolution was sought under the New Jersey dissolution upon deadlock statute, N.J. REV. STAT. § 14:13-15, which applies when, among other things, an even number of directors are evenly divided. The court held that since there were three directors *in office*, dissolution under this statute was not warranted. 140 N.J. Eq. at 447. See also 1944 REPORT OF THE NEW YORK LAW REVISION COMMISSION, RECOMMENDATIONS AND STUDIES 367 (hereinafter cited as NEW YORK REPORT); Isreals, *The Sacred Cow of Corporate Existence*, 19 U. CHI. L. REV. 778, 782 (1952).

21. *Desert Club v. Superior Court*, 99 Cal. App.2d 346, 221 P.2d 766 (1950) (three directors authorized in the articles, only two in office). See also, *Olinicy v. Merle Norman Cosmetics, Inc.*, 19 Cal. Rep. 387 (1962), Comment 48 CALIF. L. REV. at 278.

22. *In re* Friedlieb, *supra* note 19, held that the number of directors as provided in the articles was controlling and that where the board was only even for the moment due to vacancies there was not "an even number of directors." In NEW YORK REPORT, *op. cit. supra* note 20, at 367, the Friedlieb case was criticized insofar as it held that an uneven number of directors could never be rendered even by vacancies arising on the board. However, the report did approve the view that a temporary vacancy, which could be filled by directors or shareholders, was to be treated as if it were already filled.

23. *Dorf v. Hill Bus Co.*, *supra* note 20 (where a director was not permitted to perform functions of his office he did not lose his status as director); *In re* McLoughlin, 176 App. Div. 653, 163 N.Y.S. 547 (1917) (odd-man only elected to fulfill statutory requirements); *Petition of Searing*, 131 N.Y.S.2d 174 (Sup. Ct. 1954) (director adjudged an incompetent); *Application of Ades*, 12 Misc.2d 915, 177 N.Y.S.2d 574 (Sup. Ct. 1953) (director in the military service and unable to attend meetings); *In re Friedlieb* 184 N.Y.S. 753 (Sup. Ct. 1920) (director sold all his stock and withdrew from participation in management). See also, *Barkin, Deadlock and Dissolution in Florida Corporations: Litigating and Planning*, 13 U. MIAMI L. REV. 395, 408 (1959). *But cf.*, *In re* Fehrenbach, 155 Misc. 663, 281 N.Y.S. 149 (1935).

24. 258 App. Div. 1041, 17 N.Y.S.2d 1020 (1939), *reversing* 172 Misc. 634, 15 N.Y.S.2d 4 (1939).

been elected pro forma to meet statutory requirements and had never participated in corporate affairs. The lower court rejected the "dummy director" argument and denied relief. On appeal the decision was reversed and remanded for findings as to whether the odd-man was *functioning* as a director. The higher court made no statement of its theory. If the *Binder* decision means that a director who refuses to perform the functions of his office impliedly resigns, then his *de facto* resignation must be accepted as such by the board before it is effective.<sup>25</sup> If the case is viewed as accepting the theory that a non-functioning director is simply not a director, it is the only case of its kind.<sup>26</sup> It is unlikely that the "dummy director" argument will be recognized in Missouri, for directors may "function" by refusing to vote or attend board meetings.

Section 351.323 also requires that the directors be "evenly divided." Where the board is deadlocked due to high percentage vote requirements, there will not ordinarily be an even division of directors.<sup>27</sup> There may be circumstances in which the board will be "evenly divided" though high percentage votes are needed for corporate action.<sup>28</sup> In such instances the appointment of a provisional director to break tie votes would be fruitless.<sup>29</sup>

To warrant the appointment of a provisional director it must also be shown that, due to the deadlock, "business cannot longer be conducted to advantage or . . . that there is danger that . . . property and business will be impaired or lost."<sup>30</sup> In *Jamison* the court observed that the remedy offered by the provisional director statute is less severe than that of receivership and liquidation, and that this

25. *Young v. Janas*, 34 Del. Ch. 287, 103 A.2d 299 (1954), *Lippman v. Kehoe Stenograph Co.*, 11 Del. Ch. 190, 98 Atl. 943 (1916), *aff'd* 11 Del. Ch. 412, 102 Atl. 988 (1918).

26. In *Petition of Lynch*, 54 N.Y.S.2d 111 (Sup. Ct. 1945), the odd-man was disregarded by the court. However, the decision may be distinguished from the *Binder* case on the grounds that here the third man was not really *in office*. Petitioner asserted that one of the three directors was elected for the sole purpose of complying with statutory requirements. The alleged "dummy director" submitted an affidavit to the effect that he *had not been re-elected* from year to year and had never functioned in any way as a director and that he refused to be a director of the corporation. *Id.* at 111-12. The court held that there was "an even number of directors" and ordered dissolution pursuant to N.Y. GEN. CORP. LAW § 103. *Id.* at 113.

27. In Missouri the articles or by-laws may require a unanimous of high percentage vote on the board for corporate action, § 351.325, RSMo 1959.

28. *In re Hy-Lite Plastics*, *supra* note 20, allowed dissolution under N.Y. GEN. CORP. LAW § 103 where deadlock arose on a two-director board with a unanimous vote requirement for board action. The precedential value of the decision with regard to § 351.323, RSMo 1965 Supp. is diminished by the difference between the remedy sought in *Hy-Lite* and the provisional director remedy and by the fact that the votes of both directors in *Hy-Lite* were essential for a simple majority.

29. Although his vote on the board will not resolve the deadlock, the provisional director may be of some value in this situation. The use of a provisional director as a substitute for arbitration is suggested in Kessler, *The New York Corporation Law*, 36 ST. JOHN'S L. REV. 1, 60-62 (1961). Where his vote alone will not cure the deadlock, the court-appointed director's impartial views on the problems at hand may help reconcile the discordant directors.

30. § 351.323, RSMo 1959.

provision extends coverage to situations which may not necessarily call for receivership.<sup>31</sup> Thus, the deadlock need not threaten "irreparable injury," as is required to justify involuntary liquidation in Missouri.<sup>32</sup>

The California court construed the phrase, "business cannot longer be conducted to advantage," to mean that the affairs of the corporation were no longer being managed *effectively*.<sup>33</sup> It has been pointed out that lack of effective management as a test for the appropriateness of a provisional director permits a court to exercise business judgment rather than judicial discretion.<sup>34</sup> The same objection could be made to a court's determination of whether involuntary liquidation is justified.<sup>35</sup>

Section 351.323 also applies where the corporation's property or profits are in danger of being lost. If the board is completely deadlocked, there will be little difficulty in producing evidence of such commercial danger. It was held in *Jamison* that disagreement over the amount of a general manager's salary, the payment of possibly excessive rent on property leased to the corporation by a shareholder, and the employment of a member of one of the families represented on the board were of sufficient consequence that the corporation's property might be lost.<sup>36</sup>

The existence of dissension among the directors alone may indicate that business will be impaired. Deadlock situations of any kind will normally result in commercial loss.<sup>37</sup> It has been held that serious deadlock *ipso facto* constitutes sufficient danger of commercial loss to justify involuntary liquidation.<sup>38</sup> Several

31. At 36 of 158 Cal. App.2d, 322 P.2d at 251 the court states:

It is apparent that the remedy afforded by Corporations Code, section 819, is one which is available in situations which would have not yet reached the point that a receiver should or could be appointed. It is a less severe remedy which is available to protect the rights of the parties and does not reflect upon the financial standing or good name of the corporation nor does it take the property out of the hands of the owners or the persons actually administering its business. There is a readily discernable difference between a corporation not able to conduct its business to advantage or being in danger of impairing or losing its property and a corporation which is in danger of cessation or diminution of operations.

32. §§ 351.485 (1) 1 (a)—490, RSMo 1959.

33. In 158 Cal. App.2d at 37, 322 P.2d at 251, the court observed that several directors and officers were holding over in office due to tie-votes on the board and that no action was being taken on important management decisions. It was there stated:

We do not feel that perpetuation of existing policies or incumbent officers in office can be construed as *effectively managing* corporate affairs. In our opinion the trial court acted within its jurisdiction and properly in appointing the provisional director. *Id.* at 36. (emphasis added.)

See also, Comment 48 CALIF. L. REV. 272, 280 (1960).

34. Comment, 48 CALIF. L. REV. 280, n. 35.

35. The difference between the facts justifying a provisional director appointment and receivership seems to be merely one of degree. See Comment, 48 CALIF. L. REV. 279, n. 32 (1960).

36. 158 Cal. App.2d at 38, 322 P.2d at 252.

37. *Levant v. Kowal*, 350 Mich. 232, 86 N.W.2d 336 (1957), *TINGLE*, *op. cit.* *supra* note 9, at 140. See *LATTIN, CORPORATIONS* 557 (1959).

38. *Drob v. National Memorial Park, Inc.*, 28 Del. Ch. 254, 41 A.2d 589 (1945) (complete corporate paralysis necessarily causes imminent danger of loss); *Flemming v. Heffner & Flemming*, 263 Mich. 561, 248 N.W. 900 (1933); *Nashville*

states allow liquidation of assets where an even number of directors is evenly divided over the management of the corporation. Under these statutes no further injury to the corporation need be shown.<sup>39</sup>

#### D. Powers of the Provisional Director

Section 351.323 gives the court-appointed director "all the rights and powers of a director," including the right to notice of all meetings of the board and the power to vote at all such meetings. In the *Jamison* case it was contended that the provisional director did not have the power to vote for an amendment to the articles of incorporation. This contention was rejected on the grounds that the statute expressly gave him the right to vote at board meetings.<sup>40</sup> However, no cases have dealt with "rights and powers" beyond the provisional director's right to vote and receive notice of meetings. His power to act as president of the corporation may be dubious in view of the purpose of the statute and the temporary nature of this remedy.

If the provisional director has a right to notice of all board meetings as required by section 351.340, RSMo 1965 Supp., he also should have the power to waive such notice in writing after any meeting as permitted by section 351.655, RSMo 1959.

#### E. Duties and Liabilities

The duties and liabilities of the provisional director are not clearly spelled out in section 351.323. The statute provides that he is to be an impartial person who is not a shareholder or creditor of the corporation and who is not related to any of the directors or officers or to the judge who appoints him. The terms of the statute probably authorize courts to impose a duty upon him to remain impartial while he is on the board of directors. The court-appointed director may be tempted to choose sides for unworthy reasons.<sup>41</sup> Since the statute characterizes the provisional director as being a non-shareholder, it may be proper for courts to disallow any trading in the stock of the corporation during his directorship.<sup>42</sup>

Packet Co. v. Neville, 144 Tenn. 698, 235 S.W. 64 (1921) (such dissension that business could not be handled properly), see Annot., 13 A.L.R.2d 1260, 62 (1950).

39. See statutes cited note 18 *supra*.

40. 158 Cal. App.2d at 40, 322 P.2d at 253.

41. For example, he may vote with those directors who represent a majority of the voting shares in order to avoid being removed. Section 351.323 provides that the provisional director may be removed "by order of the court or by the vote or written consent of the holders of a majority of the voting shares." Whether the legislature intended to allow removal of this court-appointed director without cause is not clear. It is submitted that he is so removeable. Another possibility is that the group which offers him the most compensation for his services will receive the provisional director's tie-breaking vote.

42. A court may be justified in removing the provisional director if he does acquire stock in the corporation. Regarding an accounting for profits received in such transactions, most courts, including Missouri, hold that there is no fiduciary duty which renders a director accountable for buying and selling the corporation's stock. *Wann v. Scullin*, 210 Mo. 429, 109 S.W. 688 (1908), 3 FLETCHER CYC. CORP. § 1168.1 (Perm. Ed.). Compare *Geller v. Transamerica Corp.*, 53 F. Supp. 625,



In regard to the various other statutory and court-imposed duties and liabilities which an ordinary director owes to the corporation, the statute is silent. The circumstances attending the provisional director's appointment are replete with possibilities for abuse of power. One such possibility is that he will appropriate "corporate opportunities." Since the provisional director's vote will be decisive on important management decisions, he ordinarily will know in advance what action the board will take on a particular matter. Having such information, he may use it for personal advantage and to the detriment of the corporation.

In addition to a duty to remain impartial, there are equally strong reasons for holding the provisional director to the fiduciary duties of an ordinary director. There is authority for the proposition that anyone who has assumed the office of director is subject to the duties of a director.<sup>43</sup> Even a *de facto* director is liable for failure to use due care and for breach of fiduciary duty.<sup>44</sup> The provisional director is no less a director than is a *de facto* director.<sup>45</sup> Under this view the provisional director will be subject to the statutory liability for declaration of unauthorized and illegal dividends.<sup>46</sup> A director may not rely on his *de facto* status to avoid statutory liabilities.<sup>47</sup>

If the provisional director will be held to the duties of an ordinary director, at least one problem arises in applying the fiduciary obligations. In regard to the provisional director's salary section 351.323 provides that he:

. . . shall be entitled to receive such compensation as may be agreed upon between him and the corporation, and in absence of such agreement he shall be entitled to such compensation as shall be fixed by the court.

Apparently this provision abrogates the common law prohibition against directors receiving salaries for services unless otherwise provided in the articles or by-laws.<sup>48</sup>

630 (D. Del. 1943), *aff'd*, 151 F.2d 534 (3 Cir. 1945), with *Speed v. Transamerica Corp.*, 71 F. Supp. 457 (D. Del. 1947), *ruling reconsidered* 99 F. Supp. 808 (D. Del. 1951). However, the provisional director will be liable for profits derived from "short swing" dealings in the stock of the corporation under section 16 of the Securities Exchange Act of 1934, 15 U.S.C. § 78 (p). The act covers "any director of a corporation or any person performing similar functions. . . ." 15 U.S.C. § 78 (c) a (7) (Emphasis added); *Lockheed Aircraft Corp. v. Rathman*, 106 F. Supp. 810 (D.C. Cal. 1952).

43. STEVENS, CORPORATIONS 744, n. 33 (2d ed. 1949).

44. *Lazenby v. Henderson*, 241 Mass. 177, 135 N.E. 302 (1922); *BALLANTINE, CORPORATIONS* 149, nn. 37-38 (rev. ed. 1946); *HENN, CORPORATIONS* 337 (1961); *LATTIN, CORPORATIONS* 236 (1959).

45. A *de facto* director is one who is not a duly elected and acting director but does (a) exercise the functions of a director (b) under some color of office. *HENN, op. cit. supra* note 44, at 150, n. 41, *LATTIN, op. cit. supra* note 44, at 235.

46. § 351.345, RSMo 1959 imposes liability on the directors of a corporation for knowingly declaring and paying any dividend which is not permitted therein.

47. *McKeehan v. Pacific Finance Co.*, 120 Cal. App. 578, 8 P.2d 213 (1932), *Blackwelder v. D'Escole Enterprises, Inc.*, 148 So.2d 721 (Fla. 1963), *aff'd* 181 So.2d 373 (Fla. App. 1966).

48. *Welden v. Stephens Farm Loan Co.*, 213 S.W. 54 (Mo. 1919); *Kennedy v. Boken Associates, Inc.*, 381 S.W.2d 39 (St. L. Mo. App. 1964); *O'Brien v. John O'Brien Boiler Works Co.*, 154 Mo. App. 183, 133 S.W. 347 (St. L. Ct. App. 1911). See also, *Stoiber v. Miller Brewing Co.*, 257 Wis. 13, 42 N.W.2d 144 (1950).

Should the board and the provisional director agree on a salary prior to the court-appointed director's service on the board, he will not have breached his fiduciary duty. If he participates *as a member of the board* in deciding on his own compensation, the provisional director is an "interested director." Should his vote be necessary for a majority, as will commonly be the case, the agreement for his compensation may be voidable at the option of the corporation.<sup>40</sup> A recent Missouri case held that even where some of the votes necessary for board action are those of interested directors, the contract will stand if fairly and openly entered into.<sup>50</sup> If the amount of the provisional director's salary is unreasonably high, the excess is void as a waste of corporate assets.<sup>51</sup>

F. *Restriction of the Remedy in the Articles, By-laws or by Shareholders' Agreements*

Availability of the provisional director remedy may be denied by adequate planning in the articles or by-laws of the corporation. The articles may provide for an odd-numbered board of directors.<sup>52</sup> If the number of directors is to be even in order that the power distribution on the board be equal, the articles may require a vote greater than a simple majority for major management decisions.<sup>53</sup> Although section 351.323 applies "notwithstanding any provisions of the articles or by-laws," an outright restriction on the right to petition for appointment of a provisional director may be enforceable as a shareholders' agreement.

Several types of shareholders' agreements may restrict the provisional director remedy. A pooling agreement or other voting arrangement might provide that in the event of deadlock the shares will be voted for voluntary dissolution. The contract would have to be binding on the holders of at least two-thirds of the voting shares.<sup>54</sup> Technically this sort of agreement does not conflict with the provisions of

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49. Contracts made in the absence of a disinterested quorum and voting majority are voidable. *People's Bank of Butler v. Allen*, 344 Mo. 207, 125 S.W.2d 829 (1939); *Kitchen v. St. Louis, K.C. & Mo. Ry.*, 69 Mo. 224 (1878). This applies to agreements for compensation of directors. *Ward v. Davidson*, 89 Mo. 445, 1 S.W. 846 (1886); *R. T. David Mill Co. v. Bennet*, 39 Mo. App. 460 (K.C. Ct. App. 1889). The basis for the rule is that a director owes his undivided loyalty to the corporation and may not represent the corporation in transactions where he has conflicting interests which may influence his action. This reasoning applies a fortiori where the provisional director casts the decisive vote on his own salary.

50. *Yax v. Dit-Mco Corp.*, 366 S.W.2d 363, 367-68 (Mo. 1963). See 29 Mo. L. REV. 90 (1964).

51. If the salary of a director is out of proportion to the value of his services, the contract may be ratified by a majority of the shareholders only as to the amount of compensation which is reasonable. The excess is void as a waste of corporate assets. *Fogelson v. American Woolen Co.*, 170 F.2d 660 (2d Cir. 1948); *Rogers v. Hill*, 60 F.2d 109 (2d Cir. 1932), *Kerbs v. Calif. Eastern Airways, Inc.*, 33 Del. Ch. 69, 90 A.2d 652 (Sup. Ct. 1952).

52. § 351.055 (6), RSMo 1959. See Comment, 48 CALIF. L. REV. at 280. *But cf.*, p. 3 *supra*.

53. See p. 4 *supra*.

54. In Missouri voluntary dissolution may be accomplished by the written consent of all the holders of outstanding shares or by approval of a board resolution recommending voluntary dissolution by two-thirds of the voting shares.

section 351.323. The provisional director statute does not grant the right to petition where *voluntary* dissolution proceedings are in progress.<sup>55</sup> However, it is arguable that this type of agreement is void as contrary to public policy in that it withdraws the shareholders' statutory right to consider the alternative remedies and to vote freely on the question of dissolution.

According to the weight of authority, shareholders may contract to dissolve the corporation in the event that the board becomes deadlocked.<sup>56</sup> In *Application of Hega Knitting Mills*,<sup>57</sup> a New York court enforced a shareholders' agreement to vote for dissolution upon the occurrence of various specified events. It was conceded that the agreement violated the shareholders' statutory right to vote. However, this slight infringement on the statute did not render the contract invalid under the doctrine of *Clark v. Dodge*.<sup>58</sup>

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§§ 351.460-465, RSMo 1959. If the agreement is binding on the holders of two-thirds of the voting shares, it would be necessary to obligate a majority of the directors to submit the forementioned resolution. The director's duty to manage the affairs of the corporation may be infringed upon by such a provision. See § 351.310, RSMo 1965 Supp.

55. A provisional director may be appointed "whether or not an action is pending for an involuntary winding up or dissolution of the corporation." § 351.323, RSMo 1959. (Emphasis added.) This provision clearly only has reference to involuntary liquidation proceedings brought pursuant to § 351.485 (1) 1, RSMo 1959.

56. *Wolf v. Arant*, 88 Ga. App. 568, 77 S.E.2d 116 (1953); *Leventhal v. Atlantic Finance Corp.*, 316 Mass. 194, 55 N.E.2d 20 (1944); *Application of Hega Knitting Mills*, 124 N.Y.S.2d 115 (Sup. Ct. 1953), see Annot., 154 A.L.R. 268 (1945). *But cf.*, *Re Peveril Gold Mines*, [1898] 1 Ch. 122 (dictum); *Flanagan v. Flanagan*, 73 N.Y.S.2d 267 (Sup. Ct. 1947), *modified* 273 App. Div. 918, 77 N.Y.S.2d 682 (Sup. Ct. 1948), *aff'd* 298 N.Y. 787, 83 N.E.2d 473 (1948). Cary, *How Illinois Corporations May Enjoy Partnership Advantages*, 48 Nw. U. L. Rev. 427, 39 (1953): 5 FLETCHER, *CYCLOPEDIA OF CORPORATIONS* 249 (perm. ed. rev. repl. 1952); Hornstein, *Stockholders' Agreements in the Closely Held Corporation*, 59 YALE L. REV. 1040, 46 (1950); Isreals, *op. cit. supra* note 20, at 82; BAR, *MISSOURI PRACTICE HANDBOOK* No. 6, *MISSOURI BUSINESS ENTERPRISES* 248 (1962), see Annot., 45 A.L.R.2d 799 (1956). The Flanagan case seems to be the only decision holding to the contrary. It involved a shareholders' agreement which provided that upon the death of either of the parties, two brothers, the assets of the corporation were to be distributed pro rata between the estate of the deceased and the survivor. The wives of both brothers were shareholders, but neither was a party nor did either give her consent to the agreement. After the death of one of the two brothers his personal representatives sued for specific performance of the contract. The court held that this arrangement violated public policy. The basis for the decision seems to have been that the agreement treated the corporation as if it were a partnership and that it failed to comply with the statutory method of distributing assets upon liquidation. The contract to dissolve might have been held valid had the statutory method for liquidation and distribution of assets been followed. Isreals, *op. cit. supra* note 20, at 791; Cary, *op. cit. supra* note 56, at 439. See generally, Kessler, *op. cit. supra* note 29, at 67. N.Y. GEN. CORP. LAW § 1105 now expressly authorizes shareholder agreements to dissolve.

57. 124 N.Y.S.2d 115 (Sup. Ct. 1953).

58. 269 N.Y. 410, 199 N.E. 641 (1936). In *Clark* an agreement was held valid which provided that Clark would be appointed general manager and would continue in that capacity so long as he remained "faithful, efficient and competent." N.Y. GEN. CORP. LAW § 27 provided that "the business of a corporation shall be managed by its board of directors." Since the hiring and firing of employees and

Although there is no authority on this particular point in Missouri, there is reason to believe that courts will uphold agreements to dissolve upon deadlock. The Missouri Supreme Court has held that the shareholder's constitutional right to vote in elections for directors may be denied by shareholder agreement.<sup>60</sup> If shareholder agreements may legally withdraw a *constitutional* right to vote, it is likely that they may deny any *statutory* right to vote.

Another type of shareholder contract involves restriction of the remedies for deadlock to devices other than the provisional director appointment. If Section 351.323 is mandatory, such an agreement may be contrary to public policy and unenforceable.<sup>61</sup> Here the encroachment on the statutory provisional director remedy is direct and substantial. Should the holders of two-thirds or more of the outstanding shares be bound by the contract, one-half of the directors may nevertheless petition under section 351.323 in the event of deadlock. In close corporations, where deadlock is not uncommon, the directors are ordinarily identical with shareholder interests.<sup>61</sup> Roughly the same percentage of directors as of shareholders will be bound by the agreement.<sup>62</sup> Thus, under the agreement in question the statutory right of shareholders and directors to petition for a provisional director is abrogated. This goes beyond the negligible invasion of the statutory right in-

officers was the responsibility of the board, the contract was an invasion of the board's power and consequently a violation of the statute. However, this invasion was "so slight as to be negligible." 269 N.Y. at 417.

59. State ex rel. Frank v. Swanger, 190 Mo. 561, 89 S.W. 872 (En Banc 1905) (non-voting preferred stock); Shapiro v. Tropicana Lanes, Inc., 371 S.W.2d 237 (Mo. 1963) (non-voting common stock). See Pittman, *Non-voting Shares—In Missouri*, 26 Mo. L. REV. 117 (1961).

60. In *Leventhal v. Atlantic Finance Corp.*, 316 Mass. 194, 55 N.E.2d 20 (1944), liquidation or dissolution was disallowed until certain specified events transpired. One shareholder sought dissolution prior to the existence of the necessary conditions. It was asserted that the shareholder agreement was contrary to the public policy of Massachusetts. The court reasoned that the question of public policy was to be resolved by determining whether the statute involved was "mandatory" or "permissive." MASS. GEN. LAWS ANN. ch. 155, § 50 (1937), provided that "unless otherwise provided in the agreement of association" the corporation could, by vote of a majority of its members, file a petition for dissolution. (emphasis added). The statute was held to be "permissive" and the agreement was enforceable. This decision was based, in part, upon the fact that the statute expressly allowed restriction on the right to dissolve to be made in the "agreement of association." Under the *Leventhal* theory, the provisional director statute may be "mandatory," for it expressly forbids restriction of the provisional director remedy in the articles or by-laws of the corporation. It has been suggested that a shareholders' agreement should not be allowed to accomplish what is not allowed in the articles or by-laws. Comment 48 CALIF. L. REV. 272, 281.

61. 2 O'NEAL, CLOSE CORPORATIONS 167 (1958).

62. The shareholders have the right to cumulate their votes in elections for directors so that they will be able to obtain representation on the board in proportion to their shares. MO. CONST. ART. XI, § 6; § 351.385, RSMo 1959, State ex rel. Frank v. Swanger, *supra* note 59, at 876. Thus, in a close corporation almost all of the shareholders will normally be represented on the board. However, the shareholders' agreement in question may not be binding on the same parties as directors.

volved in the *Hega* and *Clark* cases. This sort of agreement sterilizes the statutory provisional director remedy and perhaps should be against public policy.<sup>63</sup>

Notwithstanding the above analysis, Missouri courts may enforce such shareholders' agreements. In view of the cases holding that the shareholder's *constitutional* right to one vote per share of stock in elections for directors may legally be taken away by contract, it is possible that *any statutory right* may be withdrawn by shareholder agreement.

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63. In *Long Park, Inc. v. Trenton-New Brunswick Theatres Co.*, 297 N.Y. 174, 77 N.E.2d 633 (1948), the shareholders' agreement completely gave over the management of the corporation to one person, not a director, and provided that the management could not be changed except by certain named arbitrators. It was conceded that the contract infringed upon N.Y. GEN. CORP. LAW § 27 which provides that the corporation is to be managed by the board of directors. This section was also involved in *Clark v. Dodge*, *supra* note 58. The Long Park agreement was similar to the one upheld in *Clark* as being only a "negligible invasion" of the powers of the directors. However, the court distinguished the *Clark* case on the grounds that the Long Park contract *sterilized* the powers of the directors. 297 N.Y. at 179. The agreement was held invalid as against public policy.