Missouri Law Review

Volume 37
Issue 2 *Spring 1972*

Article 8

Spring 1972

Book Review

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F. Hodge O'Neal: *Close Corporations: Law and Practice.* Chicago, Callaghan & Co. 2d ed. 1971. Looseleaf, 2 vol., $75.00.

Since its original publication in 1958, the first edition of Hodge O'Neal's treatise on close corporation law and practice[1] has ranked as the definitive work on the subject. Important among its many significant contributions was the fact that this treatise served to focus national attention on the distinctive needs and legal problems of closely held corporations and to urge courts, legislatures and lawyers to recognize these problems and adjust to meet them. In addition, this treatise provided both practitioner and scholar with a sophisticated resource on all aspects of the subject. Due in significant respect to O'Neal's pioneering work in the area, there have been substantial changes over the intervening years in both legislative and judicial recognition of and provisions for the particular problems of close corporations, and today close corporation law and practice has become recognized as a distinct and highly complex branch of general corporate law and practice.[2] These events—plus the fact that there have been many other developments of importance to close corporations in the areas of corporate, securities and tax law since 1958—make the publication of the second edition of O'Neal's treatise extremely timely and welcome.

For the uninitiated, the subject—close corporation law and practice—may require a brief word of explanation. American corporate law has developed generally on the dual proposition that (a) any legitimate business enterprise might be incorporated upon compliance with minimal statutory requirements, regardless of its size and the number of its owners, but (b) all corporations are to have substantially the same pattern of internal organizational structure and are to operate in internal affairs under the same rules, specified by statute. Over the past century, a progressive simplification of the statutory procedure and requisites to incorporate has paralleled both the rise of the giant corporations, with nationally and internationally dispersed shareholders and business activities,[3] and the vast increase in the use of the corporate form for the organization of the smaller business enterprise with a limited number of owners.[4] Pragmatically considered, the two are entirely distinct types of business enterprise, each of

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1. F. O'NEAL, CLOSE CORPORATIONS: LAW AND PRACTICE (1958).

2. *See, e.g.*, W. CARY, CASES AND MATERIALS ON CORPORATIONS 15-21 (4th ed. unabr. 1969); N. LATTIN, R. JENNING & R. BUXBAUM, CORPORATIONS, CASES AND MATERIALS 251-52 (4th ed. 1968); F. O'NEAL, CLOSE CORPORATIONS: LAW AND PRACTICE preface & ch. 1 (2d ed. 1971).

3. *See* Louis K. Liggett Co. v. Lee, 288 U.S. 517, 548 (1933); (dissenting opinion of Brandeis, J.); *cf.* United States v. Morgan, 118 F. Supp. 621 (S.D.N.Y. 1953).

4. F. O'NEAL, *supra* note 2, § 1.11.

which has its particular organizational, financial and managerial needs and problems. Yet in legal theory and in legislative and judicial precept, both have traditionally received the same treatment.

This norm proved unsatisfactory to both types of enterprise,[5] and in many instances it became a serious trap for the unwary participant in the closely held corporation.[6] To deal with these risks, attorneys for participants in closely held corporations have, over the years, devised an intricate array of devices tailored to fit the needs of their clients. A variety of statutory changes have also been designed to aid the close corporation, and in time the courts have begun to recognize the distinctive nature and problems of the closely held corporations. Hence, a considerable part of corporate law and practice today is concerned with adjusting the traditional norms to the distinctive needs of the incorporated closely held business enterprise. This complex body of law and practice is the subject comprehensively dealt with in O'Neal's outstanding treatise.

The new edition of O'Neal's treatise is exceptional among both legal treatises and those works specially concerned with close corporation practice in that it maintains a standard of excellence on three distinct levels simultaneously. Yet it accomplishes this with a felicity of style that is direct and unassuming and that yields maximum lucidity and readability. First, O'Neal is a distinguished scholar with an established national reputation[7] and has produced in this treatise a work of comprehensive, reliably excellent scholarship on the subject of contemporary close corporation law. Thus, the treatise provides an invaluable research source for both practitioner and scholar on all aspects of the subject.

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5. With respect to the publicly held corporation the problem was one of restraint on managerial freedom, which has been progressively relaxed since 1875 on the state statutory level. This, in turn, permitted aggravated managerial abuse of fiduciary position, which prompted the recent development of an extensive new body of Federal Corporation Law under the federal securities acts. *See* W. CARY, *supra* note 2, at 9-15, 712-14.

6. One sequence of famous New York cases is particularly illustrative: Long-Park, Inc. v. Trenton-New Brunswick Theatres Co., 297 N.Y. 174, 77 N.E.2d 633 (1948); Benentendi v. Kenton Hotel, Inc., 294 N.Y. 112, 60 N.E.2d 829 (1945); Clark v. Dodge, 269 N.Y. 410, 199 N.E. 641 (1936); McQuade v. Stoneham & McGraw, 263 N.Y. 323, 189 N.E. 234 (1934). In all of these cases the statutory norm—usually the provision that "the board of directors shall manage the affairs of the corporation"—was held to be a declaration of public policy and thus mandatory on all corporations, with the consequence that any inconsistent arrangement in a close corporation, although unanimously agreed to at the outset, might subsequently be held to be void and unenforceable. *Benentendi* was directly responsible for some of the earliest legislative modifications in New York to provide special treatment of close corporations. *See* F. O'NEAL, *supra* note 2, § 3.76.

7. In addition to an LL.B. at Louisiana State University in 1940, O'Neal earned the degree of J.S.D. at Yale in 1949 and the degree of S.J.D. at Harvard in 1954. To have earned two dissertation degrees at two of the nations most distinguished law schools is, in itself, an extraordinary accomplishment. In addition, O'Neal has served as dean of two law schools and as professor of law at four. Since 1959 he has been Professor of Law at Duke University, where he also served as Dean from 1966 to 1968.

Second, however, O'Neal's treatist is structured to be a highly useful practical tool for the practitioner faced with the problems of anticipating and planning for the particular needs of a client about to embark on a closely held business enterprise in corporate form. In this respect, the treatise is organized around the sequence of practical problems which confront the attorney for the close corporation, and on each of these problems it brings together the applicable corporate statutory and case law, the pertinent tax considerations, and any relevant aspects of the securities laws. In conjunction with this legal analysis, O'Neal describes the various practical solutions available for each problem and points out the relative merits in different situations of each of these alternatives. Of particular value to the practitioner is the extensive chapter devoted to specimen provisions and forms,[8] which concentrates particularly on the more difficult drafting problems peculiar to the devices most useful in close corporation planning and gives limited attention to the general corporate "boilerplate" available in standard form books. In view of the skill with which O'Neal recognizes, analyzes and suggests solutions, with specimen provisions, to the practical problems of close corporations, one would expect that the book had been written by a seasoned corporate practitioner rather than by a scholar, whose distinguished professional career has been devoted primarily to academic pursuits.[9]

Third, in addition to its scholarship and its practical utility, the treatise deals perceptively and thoroughly with the many important trends and issues of legislative and judicial policy in this rapidly changing area of corporate law. Thus, O'Neal provides a thorough analysis and critique of the recent trend to provide a separate statutory framework for close corporations, as well as an analysis of the many new developments in tax and securities laws as they affect close corporations. In these and other respects O'Neal, in this edition, has fully maintained his stature as a pioneer and effective critic in the field of close corporation law.

The fact that this treatise maintains excellence on all three levels without loss of balance or readability makes it unusually useful. Its scholarship is equal to that of leading corporate treatises,[10] which tend to omit the practical orientation so prominent in O'Neal. On the other hand, the best corporate practice manuals designed to aid attorneys in close corporation practice make no attempt to provide the high level of scholarship, analysis

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8. F. O'NEAL, *supra* note 2, ch. 10.

9. In 1941 O'Neal, shortly after graduation from L.S.U., practiced law as an associate with Sullivan & Cromwell in New York City for about a year. Military service during World War II intervened, and since 1945 O'Neal has been in law teaching and administration, successively at Mississippi, Mercer, Vanderbilt and Duke. *See* note 7 *supra*.

10. *See, e.g.*, H. BALLANTINE, CORPORATIONS (rev. ed. 1946); H. HENN, (2d ed. 1970); N. LATTIN, CORPORATIONS (2d ed. 1971), all of which are excellent.

and policy leadership that is conspicuous throughout O'Neal's treatise.[11] In this reviewer's opinion the most analagous treatise published in recent years, with a comparable balance of excellence in both scholarship and practical insight and advice, is Crane and Bromberg on *Partnership*,[12] which might well form a companion volume to O'Neal's treatise.

The format and structure of O'Neal's treatise have been improved in noteworthy respects in the second edition, but the basic organizational pattern of the first edition has been retained.[13] The most substantial change in format in the second edition is the adoption of the looseleaf form. Pocket parts in the first edition had become bulky and contained such extensive new material as to impair ready usability. This problem is eliminated by the adoption of the looseleaf form. However, perhaps in order to simplify looseleaf supplementation, footnotes have now been placed at the end of each section, rather than at the foot of the page. In most of the sections, which are reasonably short, this presents no serious problem; however, in the longer sections this arrangement becomes awkward.

The treatise has an adequately comprehensive subject index, valuable scope notes at the start of each chapter (and of several subdivisions), copious cross-references throughout the text and the usual table of cases. In addition, the second edition contains a complete set of tables listing all statutes and regulations referred to in the treatise with references to the sections in the treatise where each is discussed. This highly useful set of detailed tables includes (a) "IRC Sections, Regulations and Rulings," (b) "Securities Acts, Regulations and Releases," (c) "State Statutes" (by state), (d) "Model and Uniform Acts," and (e) "Miscellaneous Acts" (chiefly foreign).[14] Unfortunately, while the book contains a full table of contents, complete in each volume with chapter analysis at the outset of each chapter, there is no listing of the available tables anywhere. Both statutory and case tables are collected under a single divider marked

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11. *See, e.g.*, ALI-ABA JT. COMM. ON CONTINUING LEGAL EDUCATION, THE LAWYER'S BASIC CORPORATE PRACTICE MANUAL (1971); ILLINOIS INSTITUTE FOR CONTINUING LEGAL EDUCATION, CLOSELY HELD CORPORATIONS (1971), both of which are also in looseleaf form and are well done.

12. J. CRANE & A. BROMBERG, PARTNERSHIP (1968). Although this remarkable treatise, published in 1968, began as a collaboration of Professors Crane and Bromberg to produce a second edition of J. CRANE, PARTNERSHIP (1952), Professor Crane died before much had been done, and the new edition became a substantially original treatise by Professor Alan R. Bromberg, Professor of Law, Southern Methodist University. The scope and practical characteristics of that treatise are strikingly different from—and in this reviewer's opinion vastly superior to—those of the 1952 edition. *See* J. CRANE & A. BROMBERG, *supra* at xi-xii.

13. The same sequence of both chapter and section numbering is used in the second edition as in the first, which facilitates cross referencing between the two. Most of the sections have been revised to incorporate new developments, and many new sections have been added for the same reason. In doing so, to preserve the original numbering of sections, the new sections have been inserted where appropriate and designated with sequential letter suffixes.

14. The tables include separate referencing for each section of the various statutes, and for each regulation, ruling, rule and release discussed in the treatise.

"Tables" without any listing of the tables included or where they may be found.[15] In addition, a spot check reveals at least one inaccuracy in the statutory tables.[16] All references in the second edition are to sections, and pagination generally becomes insignificant due to the looseleaf form.[17]

What is a "close corporation"? And what is "close corporation law and practice"? The problems raised by these basic questions of definition are carefully considered in the opening chapter of the treatise. The answer to the second of these questions has been briefly discussed above. The first question—the test to be used to distinguish close corporations from other corporations—has puzzled both writers and legislators. O'Neal reviews the various approaches taken by others and, while recognizing that each is valid in some cases, concludes that the most satisfactory definition of a close corporation is "a corporation whose shares are not traded generally in the securities markets."[18] This is undoubtedly the best answer to the question, since it implicitly recognizes that the antithesis of the close corporation is the publicly held corporation, whose shares *are* generally traded in the securities markets, and which therefore involves an essentially different pattern of relationships between shareholders, management, the corporation and the business activity. Under this definition, it is clear that both a small local business and a giant international joint-venture corporation, owned by a limited number of other corporations to pursue specific activities, may be in fact "close corporations."[19]

This chapter is then the logical place to consider the substantial legislative developments since publication of the first edition, which tend to provide special treatment for close corporations. This O'Neal does most ably and comprehensively,[20] concluding with an important critique of these changes, in which he points out certain shortcomings and several important omissions even in the most comprehensive of the new statutes.[21] O'Neal concludes the chapter with a review of the significantly improved degree of judicial recognition of the problems peculiar to close corpora-

15. This could easily be remedied by the publisher by the preparation in the next looseleaf supplementation of a list of the specific tables included, with page reference, to be inserted immediately after the divider marked "Tables."

16. The table titled "Securities Acts, Regulations and Releases" states that section 15 of the Investment Company Act of 1940 is discussed in § 5.34 of the treatise. § 5.34 deals with the relative merits of shareholders' agreements and voting trusts and makes no mention of any of the federal securities laws. I have been unable to locate the discussion of section 15 of the Investment Company Act of 1940 elsewhere in the treatise. Hopefully, there are no other inaccuracies of this sort in the tables, but the looseleaf form permits the publisher to recheck all of the tables carefully and correct any errors in the next supplementation.

17. *See* note 13 *supra*. The pages in each chapter are numbered independently. Since all referencing in the treatise is by section number and the pagination of chapters may change with each supplementation, the page numbering is of little significance.

18. F. O'NEAL, *supra* note 2, § 1.02.

19. *Id.* §§ 1.03-.06b.

20. *Id.* §§ 1.13-.14b.

21. *Id.* § 1.14c.

tions,[22] and an able review of federal and state securities laws, with a caveat that they may apply more frequently to close corporations than commonly thought by attorneys.[23]

Having thus laid the foundation for the treatise, O'Neal devotes the next eight chapters to a careful analysis of the particular problems of close corporation law and practice. These chapters are organized on the basis of an essentially practical sequence of problems and contain innumerable helpful insights and suggestions. They fall generally into three broad categories. First, chapter 2 explores the broad range of preincorporation considerations to be analyzed with care by the attorney and his client before forming the close corporation. These include, most importantly, the selection of form of organization[24] and the state of incorporation[25] in addition to a broad range of interrelated tax and financial considerations, such as the availability of "Subchapter S" tax treatment,[26] the use of "Section 1244 Stock,"[27] the debt-equity ratio and hazards of thin incorporation,[28] the use of multiple business units,[29] the uses of classes of stock with differing characteristics,[30] tax-free incorporation[31] and selection of the taxable year.[32]

Next, chapters 3 through 7 explore in depth the range of practical problems, legal hazards and possible solutions relating to the internal organization of the close corporation and the relationships among the participants, which should be, and normally will be, dealt with carefully in the process of organization of the close corporation. Chapter 3 focuses on the basic matter of tailoring the charter and bylaws of the corporation to give maximum effect to the legitimate needs and desires of the participants. Particular attention is given to the statement of purposes and powers,[33] the stock structure and classifications of stock to achieve control arrangements,[34] the range of possibilities in the use of optional clauses,[35] the preparation of the bylaws[36] and precautions to assure effectiveness of the devices selected.[37] Chapter 4 deals extensively with the particular problems and possibilities in the use of charter and bylaw provisions designed to give shareholders a veto power over certain management actions.

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22. *Id.* § 1.15.
23. *Id.* § 1.16.
24. *Id.* §§ 2.02-.04a.
25. *Id.* § 2.06.
26. *Id.* §§ 2.04a-.04f.
27. *Id.* §2.04g.
28. *Id.* §§ 2.09-.13.
29. *Id.* § 2.05.
30. *Id.* §§ 2.14-.16.
31. *Id.* §§ 2.18-.19.
32. *Id.* § 2.21.
33. *Id.* §§ 3.06-.10.
34. *Id.* §§ 3.11-.39.
35. *Id.* §§ 3.40-.70.
36. *Id.* §§ 3.71-.76.
37. *Id.* §§ 3.77-.80.

Chapter 5 explores comprehensively the full range of control devices resulting from shareholder agreement or action. This includes examination of the many legal problems and practical possibilities in the use of shareholder agreements,[38] voting trusts,[39] irrevocable proxies[40] and agreements to delegate corporate management beyond the control of the board of directors.[41] Chapter 6 gives special attention to the problem of protecting the agreed upon employment status of shareholder employees and other key personnel against the hazards of interference with the original agreement resulting from subsequent corporation action. Chapter 7 examines the many uses of stock transfer restrictions and buy-out arrangements and analyzes carefully the many types and possible provisions of each.[42]

Finally, chapters 8 and 9 deal with the post-organizational problems which may often arise in close corporations, and which may have serious consequences for the participants whose normal remedies are few and often unattractive. In some instances these problems may be relieved by advance planning at the time of organization, but they are often difficult to anticipate and may be sensitive subjects to explore with the clients. Chapter 8 examines several problems that may arise during normal business operations, such as the hazards of disregard of corporate formalities,[43] and violations of the fiduciary duties of management and controlling shareholders to the injury of minority shareholders by withholding dividends,[44] providing excessive compensation to management,[45] creating inequitable dilution of the stock interest of the minority,[46] or buying or selling stock in the corporation on the basis of undisclosed corporate information.[47] Chapter 9 then turns to the particular problems of dissension, deadlock and dissolution. Here, O'Neal examines the variety of possible planning devices available to minimize these problems and the great utility of the

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38. *Id.* §§ 5.02-.30.
39. *Id.* §§ 5.31-.35.
40. *Id.* §§ 5.36-.37.
41. *Id.* § 5.39.
42. The treatment of both of these topics in the second edition is substantially expanded over that in the first. This is particularly true of the extensive treatment in the second edition of a broad variety of buy-out arrangements, their many possible uses in close corporation planning, and the particularly difficult aspects of drafting them effectively. *See, e.g., Id.* §§ 7.24-.24g, dealing with the intricate problem of setting the transfer price of the shares subject to a buy-out arrangement.
43. *Id.* §§ 8.02-.04.
44. *Id.* §§ 8.07-08.
45. *Id.* §§ 8.10-.12.
46. *Id.* § 8.09.
47. *Id.* §§ 8.15-16. On this topic and elsewhere in chapter 8 O'Neal has fully taken into account the massive judicial development over the past decade under § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j (1970), and SEC rule 10b-5, 17 C.F.R. § 240.10b-5 as it relates to close corporation problems of mismanagement and breach of fiduciary duties.

use of arbitration in this context.[48] The various statutory alternatives to these methods of resolving internal disputes are then examined, including equity or statutory receivership, involuntary dissolution and, in some states, the appointment of a provisional director.[49]

The rapid pace of developments in corporate, tax and securities law and in close corporation practice since 1958 have made a second edition of O'Neal's outstanding treatise imperative. All of the drastic changes in the field—from the rapid spread of specially designed close corporation statutes, to the explosive evolution of federal corporation law based on SEC Rule 10(b)-5, through the impact on close corporations of the Tax Reform Act of 1969—have been incisively included in the second edition with the high degree of skill and effective treatment that has become the hallmark of all of Hodge O'Neal's work in the field of close corporation law and practice. Neither practitioner nor scholar concerned with close corporation law and practice can afford not to include this treatise in his basic working library.

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48. F. O'NEAL, *supra* note 2, §§ 9.04-.25. Considerable stress is placed on the functional value of arbitration in this context, and on difficulties of assuring effectiveness to an agreement to arbitrate. *See Id.* §§ 9.08-.25.

49. *Id.* §§ 9.26-.30.

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