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*Corporations*ARTICLES AND BY-LAWS — STATUTORY REQUIREMENT OF
CONSISTENCY WITH LAW — CONTRACTUAL ENFORCEMENT
OF INCONSISTENT ARTICLES AND BY-LAWS*Introduction*

Chief Justice John Marshall, in a memorable decision, described the corporation as “. . . an artificial being, invisible, intangible, and existing only in contemplation of law.”¹ Little if anything need be added to his analysis to make it applicable to the present day. As an artificial being, the corporation derives its powers from the same source as its legal existence—the state of its incorporation. Those powers which the state does not expressly or by implication grant are necessarily denied to the corporation.² However, a grant of powers is often couched in general terms leaving considerable discretion to the rule-making group, whether it is the incorporators, directors, or majority of shareholders. A familiar example of this discretion is found in the corporate law of most states in the provisions concerning the contents of the articles of association or corporate charter. After requiring that the articles contain certain fundamental information setting out the proposed functions and organization of the corporation, it is often stipulated that the articles may contain any other provisions for the general management of the corporation and for the regulation of the respective rights of stockholders and directors, provided only that these additional provisions are not inconsistent with law.³ Similarly, among the usual enumerated powers of the corporation is

¹ *Dartmouth College v. Woodward*, 17 U.S. (4 Wheat.) 250, 303 (1819).

² *Chicago Title and Trust Co. v. Wilcox Bldg. Corp.*, 302 U.S. 120 (1937). This may be provided by statute. See, e.g., DEL. CODE ANN. tit. 8, § 121 (1953); N.Y. GEN. CORP. LAW § 13.

³ ALA. CODE ANN. tit. 10, § 2(10) (Supp. 1955); ARK. STAT. ANN. § 64-101 (i) (1947); CAL. CORP. CODE ANN. § 305 (c) (Deering 1953); COLO. REV. STAT. ANN. § 31-1-6(7) (1953); CONN. GEN. STAT. § 5136(6) (1949); DEL. CODE ANN. tit. 8, § 102(b) (1) (1953); FLA. STAT. ANN. § 608.03(2)(j) (Supp., vol. 18 1955); IDAHO CODE ANN. § 30-103(2) (1948); ILL. ANN. STAT. c. 32, § 157.47(1) (Smith-Hurd 1954); IND. ANN. STAT. § 25-216(12) (Burns Supp. 1955); KAN. GEN. STAT. ANN. § 17-2803(B) (1949); KY. REV. STAT. ANN. § 271.035(2) (Baldwin 1955); MD. ANN. CODE art. 23, § 4(b) (9) (1951); MASS. ANN. LAWS c. 156, § 6(h) (1948); MICH. STAT. ANN. § 21.4(2) (Supp. 1955); MINN. STAT. ANN. § 300.025 (1945); MO. ANN. STAT. § 351.055(9) (1949); NEB. REV. STAT. § 21-106(1) (1943); NEV. COMP. LAWS § 1603(9) (Supp. 1941); N.H. REV. STAT. ANN. § 294:5 (1955); N.J. STAT. ANN. § 14:2-3 (Supp. 1955);

that of making by-laws for the internal regulation of the corporation. As with the articles, a broad latitude is normally granted as to the contents of the by-laws by the absence of any restriction other than the statutory provision that the by-laws must be consistent with law and with the articles of incorporation.⁴

The requirement that articles and by-laws contain nothing which is inconsistent with law is merely an affirmation of the common-law rule that a corporation cannot authorize, by its own act, what is prohibited by law.⁵ Despite its simplicity, application of this restriction by the courts has resulted in considerable uncertainty as to both its inclusiveness and its prohibitive force.⁶ This difficulty is largely a result of the dual role which articles and by-laws perform in the corporate organization. In addition to providing the constitution and rules of the corporation, the articles and by-laws taken with the law of the state, comprise the terms of the contract between the stockholders and the corporation and between the stockholders *inter se*.⁷ Thus a standard of legality applicable to contract law is superimposed on the corporate standard. Clearly, articles and by-laws which are inconsistent with the corporate standard are not necessarily illegal in terms of a private contract. The dichotomy becomes most apparent in the case of close corporations where the entire stock is owned by a few persons who participate directly in the management of the business. Frequently the articles and by-laws of such a corporation are in fact nothing more than the terms of their agreement.⁸ In such cases, are the terms of the agreement to be subordinated to the general corporation law, and if inconsistent with this law, set aside? While the problem is more acute in the case of a close corporation, it arises whenever a corporation attempts to deviate in its articles or by-laws from statute or common law.

N.M. STAT. ANN. § 51-2-8(7) (1953); N.C. GEN. STAT. § 55-2(7) (1950); OHIO REV. CODE § 1702.04(B) (4) (Page Supp. 1955); ORE. REV. STAT. § 57.311 (h) (1953); R.I. GEN. LAWS c. 116, § 8 (1938); TENN. CODE ANN. § 48-105(7) (1955); VT. REV. STAT. § 5757 (1947); VA. CODE ANN. § 13-24(9) (1950); WASH. REV. CODE § 23.12.020 (1952); W. VA. CODE ANN. § 3015 (1955); WIS. STAT. § 180.45(2) (1953).

⁴ See, e.g., CAL. CORP. CODE ANN. § 501 (Deering 1953); DEL. CODE ANN. tit. 8, § 122(6) (1953); ILL. ANN. STAT. c. 32, § 157.25 (Smith-Hurd 1954); N.Y. GEN. CORP. LAW § 14(5).

⁵ *Jones v. Concord & M.R.R.*, 67 N.H. 119, 38 Atl. 120, 126 (1892) (dictum).

⁶ See, e.g., *Sterling v. Mayflower Hotel Corp.*, 93 A.2d 107 (Del. 1952).

⁷ *Morris v. American Public Utilities Co.*, 14 Del. Ch. 136, 122 Atl. 696 (1923); *Knight v. Shutz*, 141 Ohio St. 267, 47 N.E.2d 886 (1943).

⁸ See, e.g., *Benintendi v. Kenton Hotel, Inc.*, 294 N.Y. 112, 60 N.E.2d 829 (1945).

It is the purpose of this Note to survey the interpretations which have been given to the requirement of consistency with law, and to determine the extent to which it may be avoided by contractual enforcement of inconsistent articles and by-laws. The survey is not meant to be all-inclusive; but by examining a few of the important areas in which the conflict between the corporate and contractual standards has arisen, it is hoped that the present status of the problem may be clarified and some indication given as to the need for a more realistic approach by both courts and legislatures. The subject will be considered in two general phases: first, as to those articles and by-laws which affect the stockholder-corporation relationship; and secondly, as to those which concern the corporation itself, with particular regard to organization and management.

*Consistency with Law: Articles and By-laws Affecting the
Stockholder-Corporation Relationship*

I. Rights and Liabilities Pertaining to Ownership of Stock.

The statement that articles and by-laws must be consistent with law is generally interpreted to include common law as well as statutes.⁹ In its broadest sense, it requires that articles and by-laws be in accordance with the common and statutory law of the state, and be reasonable and not contrary to public policy.¹⁰

Is a restriction on the right of alienation of stock consistent with law when not expressly authorized by statute?¹¹ The Delaware court has held that a by-law which required that the shareholder grant an option for purchase to the corporation before selling to an outsider, was reasonable in view of the nature of the business and was not inconsistent with law.¹² In other cases, a stricter interpretation of the power to enact by-laws has resulted in the conclusion that restraints on the transfer of shares were inconsistent with the common law policy against restraints on the

⁹ *Piccard v. Sperry Corp.*, 48 F. Supp. 465 (S.D.N.Y. 1943), *aff'd mem.*, 152 F.2d 462 (2d Cir.), *cert. denied*, 328 U.S. 845 (1946); *State ex rel. Cochran v. Penn-Beaver Oil Co.*, 4 Harr. (Del.) 81, 143 Atl. 257 (1926); *Hornady v. Goodman*, 167 Ga. 555, 146 S.E. 173, 181 (1928); *Raub v. Gerken*, 127 App. Div. 42, 111 N.Y. Supp. 319 (2d Dep't 1908).

¹⁰ *Hornady v. Goodman*, 167 Ga. 555, 146 S.E. 173 (1928).

¹¹ For a statute which does authorize such restrictions, see, e.g., OHIO REV. CODE § 1701.11(B) (Page Supp. 1955).

¹² *Lawson v. Household Finance Corp.*, 17 Del. Ch. 343, 152 Atl. 723 (1930); *Accord*, *Hassel v. Pohle*, 214 App. Div. 654, 212 N.Y. Supp. 561 (2d Dep't 1925).

alienation of personal property.¹³ In these cases, the statutory grant of power to make by-laws for the regulation of transfer of stock is held to be limited to prescribing formalities, and not to authorize prohibitions against transfer.¹⁴

In the majority of cases, limited restraints on the transfer of stock have been enforced contractually without regard for the legality of the articles or by-laws as such.¹⁵ To be enforceable as a contract, it is essential that the stockholder either have assented to the restriction or have taken his stock with knowledge of it.¹⁶ A bona fide purchaser without knowledge of the restriction is not a party to the contract,¹⁷ nor is a stockholder who owned his stock prior to the imposition of the restriction and who did not assent to be bound by the restriction.¹⁸

Not infrequently, far more drastic provisions than restraints on transfer of stock are enforced by contract. In an early case, a party who took stock in a non-profit association was held to be bound by a by-law which declared that in the event annual receipts were insufficient to meet expenses, the deficit would be met by an assessment on the stock. It was conceded that, as a by-law, the provision for assessment might be invalid. However, as a term of the stockholder-corporation contract, the by-law was enforceable even if a statute which prohibited assessment against fully paid stock was applicable to this type of corporation.¹⁹ Such a statute did not prohibit the stockholders from contracting among themselves for additional assessments. If, however, the stockholders have not consented to personal liability for the debts of the corporation, and the power to impose liability is not granted by law, a by-law attempting to impose personal liability is invalid.²⁰

¹³ *Searles v. Bar Harbor Banking & Trust Co.*, 128 Me. 34, 145 Atl. 391 (1929); *Kretzer v. Cole Bros. Lightning Rod Co.*, 193 Mo. App. 99, 181 S.W. 1066 (1916); *Driscoll v. West Bradley & Cary Mfg. Co.*, 59 N.Y. 96 (1874).

¹⁴ *Kretzer v. Cole Bros. Lightning Rod Co.*, 193 Mo. App. 99, 181 S.W. 1066 (1916).

¹⁵ *New England Trust Co. v. Abbott*, 162 Mass. 148, 38 N.E. 432 (1894); *Weiland v. Hogan*, 177 Mich. 626, 143 N.W. 599 (1913); *Model Clothing House v. Dickinson*, 146 Minn. 367, 178 N.W. 957 (1920); *Baumohl v. Goldstein*, 95 N.J. Eq. 597, 124 Atl. 118 (1924); *Baum v. Baum Holding Co.*, 158 Neb. 197, 62 N.W.2d 864 (1954). *But see*, *Petre v. Bruce*, 157 Tenn. 131, 7 S.W.2d 43 (1928).

¹⁶ *Bessette v. St. Albans Co-operative Creamery, Inc.*, 107 Vt. 103, 176 Atl. 307 (1935).

¹⁷ *Driscoll v. West Bradley & Cary Mfg. Co.*, 59 N.Y. 96 (1874).

¹⁸ *March v. Fairmount Creamery Ass'n*, 32 Pa. Super 517 (1907).

¹⁹ *Blue Mountain Forest Ass'n v. Borrowe*, 71 N.H. 69, 51 Atl. 670 (1901).

²⁰ *Trustees of Free Schools in Andover v. Flint*, 54 Mass. (13 Met.) 539 (1847); *Roush v. Longdale Independent Tel. Co.*, 78 W. Va. 136, 88 S.E. 623 (1916).

Various other restrictions have been enforced contractually. Where stock is taken with notice of a by-law stating that it is subject to call for payment at any time and that the corporation shall retain a lien on the stock for the unpaid amount, the stockholder cannot insist that he is entitled to have assessments levied as prescribed by statute.²¹ Similarly, total forfeiture of stock for non-payment of installments has been enforced without regard for the power of the corporation to enact a by-law to that effect.²² ". . . [T]he question presented here is one of contract, and not of corporate power. . . ."²³ Forfeiture may also be contractually enforced for failure to conform to the regulations of the association, where the stockholder was a party to the adoption of a by-law containing this penalty or has assented to it.²⁴ Clearly forfeiture could not be imposed upon a non-consenting stockholder.²⁵

The varied restrictions and penalties which are enforced contractually without reference to their legality as articles or by-laws indicate that the courts are generally willing to overlook the requirement of consistency with law, if it can be shown that the stockholder stands in a contractual relationship in regard to the particular provision. Either contractual waiver or estoppel may be utilized to enforce the restriction. What would be clearly invalid if imposed by the corporation becomes unobjectionable if self-imposed.²⁶

The question remains as to the limits of this power of mutual self-restriction. The Delaware court has stated the answer in terms of the greatest generality:²⁷

Individuals have authority in law to enter into all sorts of contracts. But this general power to make contracts does not of course mean that every term in a contract which individuals may choose to adopt, shall in every instance be recognized as valid and binding. No individual may exercise his broad power to enter into contractual relations with another so as to offend against what the law deems to be a sound public policy.

However unsatisfactory this pronouncement may be as a statement of the law, in the absence of legislation, the problem hardly admits of a more definite answer. Distinct policy considerations

²¹ *People's Home Savings Bank v. Sadler*, 1 Cal. App. 189, 81 Pac. 1029 (1905).

²² *Lesseps v. Architects' Co.*, 4 La. Ann. 316 (1849).

²³ *Id.* at 317.

²⁴ *Bessette v. St. Albans Co-operative Creamery*, 107 Vt. 103, 176 Atl. 307 (1935).

²⁵ *March v. Fairmount Creamery Ass'n*, 32 Pa. Super. 517 (1907).

²⁶ *Baumohl v. Goldstein*, 95 N.J. Eq. 597, 124 Atl. 118 (1924).

²⁷ *Greene v. Rollins & Sons, Inc.*, 22 Del. Ch. 394, 2 A.2d 249 (1938).

are created by the corporate form of organization, and to that extent, the law will apply limitations to the contractual enforcement of articles and by-laws restricting the owner's control of his stock or imposing liabilities not warranted by corporate law. However, the same intangible standard, the public policy of the moment, which would be applied in the absence of the corporate relationship, remains as the only test of enforceability.²⁸ Thus where articles or by-laws qualify as terms of a contract but enforcement is denied, the basis of decision is not inconsistency with the corporate standard, but rather because it is the policy of the law not to enforce contracts of this nature.²⁹

II. Rights of Stockholders as Members of the Corporation.

A traditional common-law right which every stockholder enjoys in his capacity as part owner of the corporation is to inspect the books of the corporation at reasonable times and for a worthwhile purpose.³⁰ The existence of this right was bound to be viewed as suspect by management, so it is not surprising that attempts have been made to abolish or curtail it by means of restrictions in the articles or by-laws. Such attempts have been uniformly unsuccessful.³¹ In *State ex rel. Cochran v. Penn-Beaver Oil Co.*,³² the court struck down a provision in the articles which authorized the directors to determine in the particular instance whether a stockholder could examine the books. The restriction was held to be in violation of the common law, and consequently "contrary to law" within the purview of the Delaware statute.³³ The question of contractual waiver by the stockholders did not arise here, but shortly thereafter a similar provision was defended unsuccessfully on this theory. The court refused to consider the contractual waiver contention and followed its earlier decision in the *Penn-*

²⁸ See *Brooks v. State ex rel. Richards*, 3 Boyce (26 Del.) 1, 79 Atl. 790, 801 (1911); 12 AM. JUR., *Contracts*, § 166:

"Whether the effect of any specific statute can be avoided by agreement depends upon whether the statute is one enacted for the protection of the public generally or whether it is designed solely for the protection of the rights of individuals, in which case it may be waived."

²⁹ *Greene v. Rollins & Sons, Inc.*, 22 Del. Ch. 394, 2 A.2d 249 (1938).

³⁰ *Guthrie v. Harkness*, 199 U.S. 148 (1905).

³¹ *State ex rel. Brumley v. Jessup & Moore Paper Co.*, 1 Boyce (Del.) 379, 77 Atl. 16 (1910); *Klotz v. Pan-American Match Co.*, 221 Mass. 38, 108 N.E. 764 (1915); *State ex rel. Smalley v. Sterns Tire & Tube Co.*, 202 S.W. 459 (Mo. App. Ct. 1918).

³² 4 Harr. (Del.) 81, 143 Atl. 257 (1926).

³³ DEL. CODE ANN. tit. 8, § 102(b)(1) (1953).

Beaver case.³⁴

The right of stockholders to vote for the election of directors has also been regarded as sacrosanct. Articles or by-laws restricting this right have generally been invalidated as inconsistent with law.³⁵ The Delaware court has expressly held that the right to vote is not the type of personal privilege which can be waived by contrary provisions in the articles or by-laws.³⁶ Likewise, an attempt to limit voting rights to members present at the meeting cannot prevail where proxy voting is permitted by statute.³⁷

The contractual waiver theory has prevailed in at least one case³⁸ to deny to the stockholders the right to vote or to participate in the management of the corporation for a specified term of years. The restrictions in the articles were held to be consistent with law despite contrary statutory provisions. The court reasoned that the statutes were intended to apply only to those corporations which did not agree to the contrary in their charters. A more thorough emasculation of the statutes would be difficult to imagine.

The right to a hearing before expulsion from membership in an association is considered to be so basic that summary expulsion of an association member, even if in accordance with the by-laws, is ineffective.³⁹ It appears that members of the corporation may bind themselves as to the cause for expulsion but not as to an illegal manner of expulsion.⁴⁰

Where the right affected by the articles or by-laws is one which pertains to the stockholder as part owner of the corporation, whether it concerns inspection of books and records, voting rights,

³⁴ *State ex rel. Miller v. Loft, Inc.*, 4 Harr. (Del.) 538, 156 Atl. 170, 173 (1931).

³⁵ *Brooks v. State ex rel. Richards*, 3 Boyce (26 Del.) 1, 79 Atl. 790 (1911); *State ex rel. Ross v. Anderson*, 31 Ind. App. 34, 67 N.E. 207 (1903); *Penn-Texas Corp. v. Niles-Bement-Pond Co.*, 34 N.J. Super. 373, 112 A.2d 302 (1955).

³⁶ *Brooks v. State ex rel. Richards*, 3 Boyce (26 Del.) 1, 79 Atl. 790 (1911).

³⁷ *Flynn v. Kendall*, 195 Misc. 221, 88 N.Y.S.2d 299 (Sup. Ct. 1949).

³⁸ *Union Trust Co. v. Carter*, 139 Fed. 717 (C.C.W.D. Va. 1905). In this case the shareholders also signed an independent agreement waiving all rights to insist on meetings during the term of years. However, the opinion indicates that the restrictions in the articles were valid and binding in themselves.

³⁹ *Briggs v. Technocracy, Inc.*, 85 N.Y.S.2d 735 (Sup. Ct. 1948); *Gallaher v. American Legion*, 154 Misc. 281, 277 N.Y. Supp. 81 (Sup. Ct.), *aff'd mem.*, 271 N.Y. Supp. 1012 (1st Dep't 1934).

⁴⁰ *Strong v. Minneapolis Automobile Trade Ass'n*, 151 Minn. 406, 186 N.W. 800 (1922).

or any phase of corporate management which traditionally belongs to the stockholders,⁴¹ the courts have generally required strict adherence to the legal norm. Contractual waiver, which assumes such significance where individual rights to ownership and control of stock are concerned, is usually rejected where stockholders' basic group rights are involved. The reason for the difference is not elusive. A waiver of rights to ownership and control of stock directly affects only the individual who is deemed competent to waive personal rights and immunities. However, where the right is basic to the preservation of an equitable stockholder-corporation relationship, the law regards the public interest as more closely affected; and the individual's competence to waive the right is correspondingly reduced.⁴²

"Consistent with Law:" Articles and By-laws Affecting the Corporation as a Legal Entity

This section will consider the extent to which articles and by-laws may be used in their contractual sense to deviate from statutes and the common law concerning details of corporate organization, activity, and management.

At common law a director was excluded from voting or being counted towards a quorum to consider a transaction in which he had a personal financial interest.⁴³ Recently it was held by the Delaware court that this disqualification could be removed by contractual agreement in the articles.⁴⁴ The decision has particular significance because the court directly considered the effect of the statutory provision that the articles could not contain provisions "contrary to law."⁴⁵ This limitation was held not to prohibit stockholders from dispensing with some common-law rules by inserting contrary provisions in the articles. What abrogations of the common law would be too "contrary to law" to prevail, remains undecided. The court apparently would permit contractual waiver, ". . . provided that it does not transgress a statutory enactment or a public policy settled by the common law or implicit in

⁴¹ ". . . [I]rrespective of the existence of any provision in the certificate of incorporation or of a by-law, a corporation may remove a director during his term of office for cause arising from his acting in a manner inimical to the interests of the corporation. . . ." *Abberger v. Kulp*, 156 Misc. 210, 281 N.Y. Supp. 373, 376 (Sup. Ct. 1935).

⁴² See note 29 *supra*.

⁴³ *Italo-Petroleum Corp. v. Hannigan*, 1 Terry (40 Del.) 534, 14 A.2d 401 (1940); *Jacobson v. Brooklyn Lumber Co.*, 184 N.Y. 152, 76 N.E. 1075 (1906).

⁴⁴ *Sterling v. Mayflower Hotel Corp.*, 93 A.2d 107 (Del. 1952) (interlocking directorate). Cf. *Adams v. Mid-West Chevrolet Corp.*, 198 Okla. 461, 179 P.2d 147 (1947).

⁴⁵ DEL. CODE ANN. tit. 8, § 102(b) (1) (1953).

the General Corporation Law itself."⁴⁶ The distinction between an ordinary rule of the common law and a "public policy settled by the common law," is not likely to prove helpful in drafting articles of incorporation.

Prior to this statement of the law, the same court had permitted variations from common law rules, but the grounds of decision did not involve contractual waiver.⁴⁷

The problem is essentially the same where the articles or by-laws attempt to regulate the details of corporate management. The direct management of the corporation is normally an exclusive function of the board of directors, and it may be so provided by statute.⁴⁸ Control over the management is frequently sought to be retained to some measure in the body of stockholders. Particularly in a close corporation, where the stockholders often constitute the board of directors, it is not uncommon for the group to enact by-laws which leave a residuum of control to themselves as stockholders.⁴⁹ In the alternative, complete control may be retained by the directors, but by requiring the agreement of a sufficiently high percentage of the members of the board before taking action, each member may be given the power of veto.⁵⁰

Where the stockholders have sought to deprive the board of any independent power of management, the restrictions have been struck down as illegal infringements on the power of the directors, whether contained in the by-laws,⁵¹ or in an incidental agreement.⁵² Similarly, a by-law which deprives the directors of an important prerogative, such as the power to elect officers, is inconsistent with law and void.⁵³

⁴⁶ *Sterling v. Mayflower Hotel Corp.*, 93 A.2d 107, 118 (Del. 1952).

⁴⁷ *Martin Foundation, Inc. v. North American Rayon Corp.*, 31 Del. Ch. 195, 68 A.2d 313 (1949). Here the articles excluded an interested director from being counted for quorum purposes and defined the term "interested" more broadly than at common law. In *Butler v. New Keystone Copper Co.*, 10 Del. Ch. 371, 93 Atl. 380 (1915), it was stated obiter that the common law rule, which required unanimous consent of the stockholders to sell the assets of a going concern, would not invalidate a provision in the articles giving the directors authority to dispose of the assets with the consent of $\frac{3}{4}$ of the stockholders.

⁴⁸ See, e.g., N.Y. GEN. CORP. LAW § 27.

⁴⁹ *Ripley v. Storer*, 139 N.Y.S.2d 786 (Sup. Ct.), *aff'd per curiam*, 142 N.Y.S.2d 269 (1st Dep't 1955).

⁵⁰ See, e.g., *Benintendi v. Kenton Hotel, Inc.*, 294 N.Y. 112, 60 N.E.2d 829 (1945).

⁵¹ *Kaplan v. Block*, 183 Va. 327, 31 S.E.2d 893 (1944).

⁵² *Long Park, Inc. v. Trenton-New Brunswick Theatres Co.*, 297 N.Y. 174, 77 N.E.2d 633 (1948).

⁵³ *Bechtold v. Stillwagon*, 119 Misc. 177, 195 N.Y. Supp. 66 (Sup. Ct. 1922).

However, where the by-laws only slightly limit the power of the board, the restrictions may be sustained as a harmless infringement on the statute, particularly where the statute is phrased in general terms.⁵⁴ In such cases, the potentiality of harm if the restriction is upheld has been used as the standard of validity. Such a test was approved in *Clark v. Dodge*:⁵⁵

If the enforcement of a particular contract damages nobody—not even, in any perceptible degree, the public—one sees no reason for holding it illegal, even though it impinges slightly upon the broad provision of section 27.

In this case the agreement was independent of the rules of the corporation, but the same rationale has been followed where the by-laws contain the terms of restriction.⁵⁶ In permitting minor deviations, the courts have not seized upon contractual enforcement as might have been expected, but rather the infringements have been passed over as *de minimis*. Correspondingly, where restrictions have been struck down, it has been because of a basic repugnancy to the statutory norm.⁵⁷ It may be that the courts prefer to consider the contractual waiver theory as a one way street, but at any rate, where control is sought to be retained by the stockholders, the articles and by-laws must conform to the corporate standard of consistency with law.

The desire to preserve equanimity among the members of a close corporation may manifest itself in articles or by-laws which curtail the action of the directors or stockholders in the absence of unanimous agreement. The effect of such provisions where inconsistent with statute was squarely at issue in *Benintendi v. Kenton Hotel, Inc.*⁵⁸ A divided court held that by-laws which required unanimous agreement by stockholders to adopt any resolution or to elect directors were invalid because at variance with statutes. A third, which required unanimous agreement by directors to adopt any resolution, was struck down as inconsistent with the policy of the corporation law. The fourth, which required unanimous stockholder agreement to amend the by-laws, was upheld. The majority refused to consider the contention that the provisions should be enforced contractually even if invalid as by-laws. The dissent stressed the voluntary nature of the by-law agreement and the absence of policy which would prohibit contractual

⁵⁴ *Petition of Buckley*, 183 Misc. 189, 50 N.Y.S.2d 54 (Sup. Ct. 1944).

⁵⁵ 269 N.Y. 410, 199 N.E. 641, 642 (1936).

⁵⁶ *Ripley v. Storer*, 139 N.Y.S.2d 786 (Sup. Ct.), *aff'd per curiam*, 142 N.Y.S.2d 269 (1st Dep't 1955); *Petition of Buckley*, 183 Misc. 189, 50 N.Y.S.2d 54 (Sup. Ct. 1944).

⁵⁷ *Kaplan v. Block*, 183 Va. 327, 31 S.E.2d 893 (1944).

⁵⁸ 294 N.Y. 112, 60 N.E.2d 829 (1945).

enforcement.⁵⁹ The strict approach followed by the majority represents the prevailing view, particularly in the New York courts, when the corporation attempts to deviate from a specific, statutory norm. In similar cases it has been held that a by-law provision which requires a greater than plurality vote for election of directors cannot prevail;⁶⁰ neither can a by-law require a greater than majority vote to increase the number of directors,⁶¹ nor can it prescribe in excess of the statutory requirement to constitute a quorum.⁶²

It is evident that the reluctance of the courts to permit direct deviation from the statutory scheme of corporate management extends with equal force to nullify attempts to accomplish it indirectly by requiring greater unanimity by stockholders or directors than is prescribed by statute. Wherever corporate management or control is affected, the limitation of consistency with law becomes a strict standard for the validity of stockholder agreements. As in the case of basic stockholders' rights, the courts are unwilling to accept a theory of contractual waiver. However, the policy considerations which justified this attitude, where the rights sought to be restricted were essential for the protection of the stockholders against fraud by the management, do not appear to be present where the by-laws are the terms of a voluntary agreement as to the details of management of a close corporation. That is, it is difficult to see how public policy would be offended by the contractual enforcement of the type of by-laws which were struck down in the *Benintendi* case.⁶³

Conclusion

From this survey, it is clear that the statutory requirement that articles and by-laws be consistent with law is far from being an absolute or all-inclusive limitation. Where stockholders' rights relating to the ownership and control of stock are involved, the statutory limitation is subordinated to the power of the parties

⁵⁹ *Id.* at 837, "They may by agreement waive or relinquish as between themselves statutory rights where such waiver or abandonment is not contrary to the public interest."

⁶⁰ *Prigerson v. White Cap Sea Foods*, 100 N.Y.S.2d 881 (Sup. Ct. 1950); *In re Election of Directors of Rapid-Transit Ferry Co.*, 15 App. Div. 530, 44 N.Y. Supp. 539 (2d Dep't 1897).

⁶¹ *Christal v. Petry*, 275 App. Div. 550, 90 N.Y.S.2d 620 (1st Dep't 1949), *aff'd mem.*, 301 N.Y. 562, 93 N.E.2d 450 (1950).

⁶² *In re P. F. Keogh, Inc.*, 192 App. Div. 624, 183 N.Y. Supp. 408 (1st Dep't 1920); *Clark v. Wild*, 85 Vt. 212, 81 Atl. 536 (1911).

⁶³ See note 50 *supra*. Soon after this decision, the New York corporation law was amended to permit the enforcement of such agreements, as were struck down by the court, if contained in the articles of incorporation. N. Y. STOCK CORP. LAW § 9.

to waive their rights by contract. A far stricter approach is evidenced where basic stockholder rights are sought to be restricted or abolished. Generally a corporate rule containing such a restriction must fall as violative of statutes or the common law, whether or not the elements of a valid contract are present. Where the articles or by-laws deviate from law regarding the organization or control of the corporation, the decisions are not uniform. The validity of corporate rules of this type depend upon several factors: whether the law sought to be circumvented is statutory or common law; if statutory, whether it is general or specific; and whether the enforcement of the rule would be detrimental to any party or to the public. The contractual-waiver theory has been recognized by the Delaware courts as to some common law rules; but, in the main, articles and by-laws dealing with the corporation as a legal entity, particularly where management of the corporation is concerned, must be literally consistent with law.

It is far too late to suggest that many problems would disappear if articles and by-laws lost their status as terms of the corporate contract. Their dual capacity is firmly entrenched in the law, and rightly so, for the protection of the rights of all parties. However, the existence of this dichotomy should not preclude steps to resolve the conflict which it has created. It is not a satisfactory solution to say that rights may be waived or the law circumvented if the public policy of the moment is not offended.

Two factors must be considered in an analysis of the problem. First, articles and by-laws do not cease to be rules of the corporation to which the law has affixed limitations when they assume the status of terms of a contract. Consequently, to enforce illegal articles and by-laws contractually, is to make a nullity of the corporate standard. Secondly, when the law demands that the voluntary agreements of the members of a close corporation conform strictly to the corporate standard, the law loses sight of the real nature of the agreement. To require that what is essentially a contract conform to strict by-law standards is as incongruous as taking the other extreme, as the court did in *Union Trust Co. of Maryland v. Carter*,⁶⁴ and holding that the law is binding on the corporation only if not waived by agreement. The answer lies in legislation which will recognize that a different legal standard must be applied to the rules of a close corporation than to one which is publically owned. The public interest in strict regulation is far greater in the latter case. If the law permits a partnership to incorporate, the law must take cognizance of the particular problems which inhere in a body of that size, and not depend upon the mechanical application of rules tailored to fit an organization which can scarcely be said to be of the same genus.

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⁶⁴ 139 Fed. 717 (C.C.W.D. Va. 1905).