Florida's Corporate Code: Draftsmanship and Practice

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The art of drafting corporate charters and other corporate documents has lost much significance in recent years. Attorneys, for the most part, are more than willing to use forms, heedless of the echoes which may come back at a later time when the enterprise has reached the going concern stage. A “form type” of approach is, first of all, easier. It seems more expedient and uniform, but it is also “playing by ear.” It is the writer’s firm opinion that time spent on careful draftsmanship of the charter is time well spent. One of the main objectives of this article is to point out some of the pitfalls in the corporate code which lie ready to ensnare the work of the careless draftsman, and how these may be avoided through close attention to the purposes which the enterprise seeks to accomplish.

I. The Incorporators

The Code provides that “three or more” incorporators are necessary for corporations organized under the general corporation law. This obvious observation may become of considerable importance to the attorney organizing the new enterprise.

First of all, with regard to the minimum figure, it is common practice for attorneys to use the client and two “dummies” who subsequently assign their shares, with the result that the enterprise takes the form of a one-man corporation. Aside from situations where the one-man corporation has been used for evasion of statutes, fraud on creditors, or for similar evasive purposes, the practice has been given full sanction by the courts. The limited liability is not affected by the fact that ownership of all the shares rests with one or two individuals. As stated in a leading English case, “Not only do these companies (one-man corporations) exist under the sanction, even with the encouragement of the legislature, but I have no reason whatever to doubt that the great majority are as bona fide and genuine as in a business sense they are convenient and suitable for the provision and application of capital to industry.”

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2. See United States v. Milwaukee Transit Co. 142 Fed. 247 (7th Cir. 1905).
In what is apparently a case of first impression in America, however, the Supreme Court of North Carolina has struck at the heart of one-man (and two-men) corporations by holding squarely that there must be three or more "stockholders at all times in order for a legal corporate entity to exist. The reasoning in this startling case proceeded on the basis that because the statutes of North Carolina require three or more persons to obtain a certificate of incorporation and to manage the affairs of the corporation, a corporation with a single stockholder is a "dormant" corporation. Therefore, the corporate entity can be disregarded, and anyone seeking legal redress against the corporation may look immediately to the "one man." Understandably, this decision has generated much concern among lawyers and businessmen in North Carolina. Attorneys in Florida and other jurisdictions should not dismiss this case lightly, for the North Carolina statutory language in question is markedly similar to that of Florida and most other states.

The absence of any maximum figure ("three or more") is of more immediate practical importance to attorneys, especially in situations where the enterprise expects to solicit funds from the public. The point is that the Florida Securities Act applies to public offerings of securities by the corporation, i.e., sales of securities to persons not members of the corporate group. In turn, a public offering involves considerable time and expense. But the provisions of the Florida Securities Act do not operate if the subscribers are bona fide incorporators. In short, incorporators are looked upon as a closed group and no element of a public offering is present. Thus, since there is no maximum limit provided for incorporators, funds from more than three persons may be obtained, free from registration under the Florida Securities Act.

II. The Corporate Name

In Florida there is no statutory provision for reservation of the corporate name. However, the Secretary of State may not issue articles of incorporation to a corporation unless its proposed name is "such as will distinguish it from any other corporation authorized to do business

7. "Not possessing the managerial agencies—stockholders, directors or officers,—contemplated by statute, it can no longer act as a corporation. Its decisions are the decisions of the single stockholder, and its action is his action." Id. at 597, 91 S.E.2d at 586.
8. For a critical comment on the case see Comment, A Conceptualistic Tangle and The One—or Two-Man Corporation, 34 N.C.L. Rev. 471 (1956).
11. This discussion assumes that no solicitation is involved. Rather, that the more than three persons are bona fide incorporators.
in Florida." It is therefore advisable to communicate with his office shortly prior to filing the application for charter in order to ascertain whether the proposed name is available for use.

Several restrictions must be observed in selecting a name for corporate use. First, the statute expressly provides that the name must include the word "company," "corporation," "incorporated," "or such other word, abbreviation, affix or prefix as will clearly indicate that it is a corporation instead of a natural person or partnership."

The statute also expressly provides that the name must be "such as will distinguish it from any other corporation authorized to do business in Florida." It is to be noted in this connection that foreign as well as domestic corporations enjoy the protection of this section, as long as the foreign corporation in question is authorized to do business in Florida. Suppose, however, that the foreign corporation is not authorized to do business in Florida. Theoretically, then, use by a Florida corporation of a name similar to that of a foreign corporation would be lawful. Actually, however, if public deception results, the foreign corporation may obtain an injunction prohibiting use of the name by the domestic corporation.

By way of illustration, suppose that the Coca-Cola Company was not authorized to do business in Florida. Obviously, adoption of that well known name by another corporation for use in Florida would result in public deception. Close questions may arise, however, as to what constitutes "public deception." It has been stated that "generic, geographical or descriptive terms, such as the name of a city or locality or a product or industry or even a personal or family name, are given somewhat less protection than more peculiar, fanciful or artificial names." One point however is clear. The fact that the Secretary of State approves use of the corporate name is not determinative of the corporation's legal right to use it. His decision is reviewable by the courts.

12. Fla. Stat. § 608.03 (1955). See also, Fla. Stat. § 608.61 (1955). Another section of this code provides that articles of incorporation may not be issued to veterans organizations not officially affiliated with one of the national congressionally recognized veteran organizations.

13. Fla. Stat. § 608.03 (1955). Attention is called to another section of the code providing that no corporation for profit may use the term "club" so as to misrepresent itself as a religious, charitable, educational or like association. See also Fla. Stat. §§ 608.63 through 608.66 (1955).


15. Actually there is a distinction between protection of the corporate name and protection of trade names and trademarks. However, most cases have proceeded from the practical premise that protection of the corporate name is in reality a branch of the law of unfair competition. See American Steel Foundries v. Robertson, 269 U.S. 372 (1925). Note, Right to Exclusive Use of Corporate Name, 28 Cal. L. Rev. 766 (1940).


17. See Children's Bootery v. Sutker, 91 Fla. 60, 107 So. 345 (1926). This protection also extends to religious organizations. First Born Church of the Living God v. First Born Church of the Living God, 156 Fla. 78, 22 So.2d 452 (1945).

in close investigation before recommending adoption of a corporate name if there is any doubt in his mind concerning a subsequent challenge on its exclusive use.

III. THE CAPITALIZATION

Perhaps the most important phase of organization procedure concerns the initial capitalization of the enterprise. What types of securities to authorize and in what proportion such securities are to be issued among the incorporators often presents a difficult problem.

*Par and No-Par Shares*

One of the first factors to consider in this respect is control of the enterprise. Usually, distribution of voting shares among the initial subscribers will approximate their respective contributions in money or money's worth. Thus A, B, and C, incorporators, who each subscribe equally, will agree to, and expect, an equal division of voting shares. If the "close corporation" is the objective of A, B, and C, the problem is a relatively simple one. The first and most obvious allocation method involves the use of $1.00 par value voting common stock. Suppose that A, B, and C each contribute $5,000 to the new venture. Each incorporator will be allotted 5,000 shares of the $1.00 par value stock. An alternative method would involve issuance of no par value stock, A, B, and C again receiving an equal number of shares. Although the use of no par value stock has been legalized in nearly every state, certain points must be borne in mind. Where, as in our above illustration, the entire capitalization consists of no par value stock, the minimum statutory requirement of $500.00 as a condition precedent to doing business by the corporation must still be fulfilled. Secondly, the Code expressly provides that no par shares must be issued for a consideration prescribed in the certificate of incorporation, or in the absence of such a prescription, then for such consideration as may be fixed by the stockholders or by the board of directors.

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19. Although there is disagreement among corporate authorities on the proper definition of a close corporation, its hallmark is normally the identity between ownership and active management. Normally, too, the close corporation is one wherein all of the issued stock is owned by a small number of persons.

20. Fla. Stat. § 608.15 (1955) provides that authorized shares of par value stock may be issued only for a consideration having a value, in the judgment of the board of directors, at least equivalent to the full par value of the stock so to be issued. In the absence of fraud in the transaction, the judgment of the directors as to the value of the consideration is made conclusive. Conversely, if the incorporators wish to create a paid-in surplus, they may decide to allocate a lesser number of shares to themselves at a price in excess of the par value.

21. Apparently, Nebraska is the sole exception. Article XII, § 6 of its constitution provides that "all stock shall have a face par value; and all stock in the same corporation shall be of equal value. See also Goodbar, *No-Par Stock, Its Nature and Use*, 3 Miami L.Q. (1948).

22. Fla. Stat. § 608.03 (1955). At its 1957 session, however, the Florida Legislature repealed that provision of the code requiring that "the sum of the values of the consideration for subscribers' stock shall not be less than the amount of capital with which the corporation will begin business."
directors acting pursuant to authority granted by the stockholders or conferred by the certificate of incorporation. Finally, tax considerations may affect the decision of whether or not to issue no par value shares. Frequently statutes attribute to no-par shares, for purposes of computing organization, original issue, and transfer taxes, an arbitrary value. Frequently, too, this assigned value is considerably higher than the value of the consideration actually paid for the shares. Because of these and other obstacles sometimes placed in the path of no-par shares, attorneys today increasingly make use of low-par value shares rather than no par value shares.

Voting and Non-Voting Shares

Assuming that public investors are to be invited to subscribe to shares in the enterprise, the element of control may be of vital importance to those persons who organized it. It is apparent that if outsiders are issued voting shares, those outsiders may have the opportunity to unite and assume control of the enterprise. Several alternatives present themselves at this point from the standpoint of protection of the organizers.

One commonly used protective device simply involves issuance of fifty-one percent of all voting stock to the organizers. Danger lurks even here, however, in the fact that one or more of the organizers may sell or otherwise dispose of their shares to outsiders, thus jeopardizing the controlling position of the remaining organizers. A partial solution lies in the careful drafting of a restrictive transfer agreement, a topic to be discussed shortly. Further objection to fifty-one percent issuance to the organizers may manifest itself in the form of a cool reception by underwriters and the public to public offer of the shares for sale; the feeling may well develop that the organizers are taking “too big a piece” of the enterprise.

As an alternative, a relatively small number of voting common shares may be issued to the organizers, while non-voting common shares are authorized for issuance to outsiders. Use of non-voting common stock is permissible in Florida. In this manner the organizers are absolutely free from interference with their controlling position as long as the voting shares are not sold or otherwise disposed of to outsiders. Here again, however, practical objections are presented. Prominent among them is the likelihood of cool public reception. Especially in the case of common stock, the public investor is apt to suspect a situation wherein he is given no voice in management. In addition, if the securities are to be offered

24. See, for example, FЛА. STAT. 608.33 (1955), where each share of no par value is presumed to have a value of “at least $100.00 per share, which presumption may be overcome by actual proof submitted to the secretary of state.” See also FЛА. STAT. 608.5 (1955) (original issue tax).
for sale across state lines, several federal statutes restrict the use of non-
voting shares. Finally, if the shares are to be listed on an exchange, the exchange regulations may prohibit listing of non-voting stock.

Preferred Shares and Bonds

Still another alternative involves the issuance, to outsiders, of preferred shares or bonds. In this manner, of course, voting control can be retained by the organizers. In the opinion of the writer, however, issuance of preferred shares or bonds by a new enterprise is unwise financial practice. Preferred shares and bonds represent investment, not speculative, media. Since most new ventures are speculative, proper securities for public subscription are common stocks, not bonds or preferreds. The Florida Securities Commission has taken this position in a recent policy release, stating that: “The Commission does not look with favor upon new corporations issuing interest securities or preferred stock, except in rare cases which are justified by a reasonable excess of assets over liabilities to the extent of meeting principal requirements.”

Aside from this administrative policy objection, however, there are practical and seemingly convincing arguments, especially against the issuance of bonds, even by many “seasoned” corporations. First and most important, in corporate enterprise, the need for management appreciation of the danger of going into debt is urgent. In deciding what type of securities to issue, undue weight is often given to that section of the Internal Revenue Code which permits corporations to deduct interest paid on their outstanding debts. Dividends paid on common and preferred shares, of course, are not deductible. But what is often overlooked is the simple fact that the bond represents a debt—fixed obligation, payable at all events on a stated date. To a new enterprise such a security may well prove disastrous. Even a going concern should not go into debt unless absolutely necessary.


27. Statement of Listing Requirements, New York Stock Exchange (May 4, 1940); Statement of Policy of Committee on Listing re Voting Rights, New York Curb Exchange (Nov. 12, 1946).

28. This statement assumes, of course, that the preferred shareholders or bondholders are not granted voting rights.


31. An even stronger position on this point is taken by the American Institute of Management: “The Institute’s own analysis further strengthens the obvious conclusion that there is an over-reliance on debt financing today—and a trend toward even greater reliance on debt. True, business is prosperous . . . but business has expanded at the expense of its creditors.” The Doubtful Value of Corporate Debt, American Institute of Management (May, 1953).
Assuming then, that the enterprise, especially the new corporation, will authorize and issue equity securities rather than fixed interest obligations, draftsmanship becomes exceedingly important if the objective is the usual one—maintenance of control among the organizers.

IV. Restrictive Transfer Agreements

Faced with the previously discussed possibility of mobilization by outsiders in the event that the controlling shares are sold or otherwise disposed of, the organizers may nevertheless effectively achieve retention of control by means of a carefully drawn restrictive transfer agreement. The objective of this agreement is to insure that any portion of the controlling shares will be offered to the other organizers or to the corporation prior to being disposed of to outsiders. It is to be noted in this connection that the agreement must take the form of a first refusal; absolute restraints on alienation of shares are void. Similarly, agreements which make the corporation the only possible purchaser or which prohibit the transfer of shares without prior consent of the directors or the other stockholders will be held invalid. As long as the restraint is reasonable, however, it will be upheld. Statutory authority for such restrictions is contained in the Uniform Stock Transfer Act.

Precise draftsmanship, however, is necessary, because in construing such agreements, courts will not enlarge the restrictions by implication. For example, the agreement should clearly specify whether the restrictions imposed on transfer of the shares apply only to voluntary inter vivos sales or also to gifts, testamentary dispositions, intestate successions or other transfers by operation of law. Similarly, are transfers to existing shareholders or to members of the immediate family of the transferor within the scope of the restriction? These points should be expressly dealt with in the agreement.

Still another factor to be clarified in the restrictive transfer agreement concerns the optionees. Is the option to run in favor of all parties to the agreement? To a selected few? To the corporation? Is there any order of priority among optionees? If so, what is the order of priority? On

32. The normal procedure involves the drafting of a separate stockholders' agreement, signed by all parties concerned. However, restrictive transfer provisions could be made a part of the by-laws or even included in the corporate charter. See Annot. Validity of Restrictions on Alienation or Transfer of Corporate Stock, 65 ALR 1159 (1929); 138 ALR 647 (1941).
34. Ibid.
35. See Johnson v. Laflin, 103 U.S. 800 (1880).
37. FLA. STAT. § 614.17 (1955).
38. See Stem v. Stem, 146 F.2d 870 (D.C. Cir. 1944), wherein it was held that a by-law requirement of a first offer to the corporation did not prevent a shareholder from effectively disposing of his shares by testamentary provision.
what basis are the optionees given the right to exercise the purchase option? In answer to this last question, normal participation is based upon the pro rata share of a stockholder's interest.\(^3\)

Consideration of an important statutory requirement in connection with restrictive transfer agreements merits attention. Although, by means of such agreements, free transferability of shares may be prevented, the Uniform Stock Transfer Act provides that "there shall be no restriction upon the transfer of shares . . . unless the restriction is stated upon the certificate."\(^4\) Accordingly, in order to insure the enforceability of such agreements against third persons, proper reference to them should be placed on the face of the stock certificate.\(^4\)

The next problem which must be dealt with concerns the price at which the purchase is to be made. Several alternatives are possible: mutual agreement, book value, capitalization of prior earnings, market value, arbitration.

The mutual agreement method often leaves much to be desired. In the first place, an agreement to agree on a fixed price would be unenforceable for lack of consideration.\(^4\) On the other hand, an agreement to purchase and sell at a fixed price determined at the time of making the agreement is equally unsatisfactory, for the actual value of the shares may be subject to constant fluctuation.

The book value method of valuation is satisfactory only if the term "book value" is clearly defined in the agreement. That term, as ordinarily used in accounting practice, connotes the addition of all tangible assets of the company, then deducting all debts and other liabilities, plus the liquidation price of any preferred stock. The sum arrived at is divided by the number of common shares outstanding, and the result is the book value per common share. It is at once apparent that book value, as thus defined, may have little or no significant relationship to the actual value of the shares. In the first place, intangibles such as good will are excluded although these intangibles may constitute a very real part of the actual value of the company. Secondly, neither market appreciation over cost of fixed assets nor market depreciation is reflected. In periods of rising (or falling) prices, the true value picture may be badly distorted.\(^4\) Unless, then, the aforementioned factors are dealt with and clearly spelled out

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39. See Greenwood v. Rotfort, 158 Fla. 197, 28 So.2d 825 (1946).
40. FLA. STAT. § 614.17 (1955).
41. The terms of the restriction need not be set forth on the certificate. Weissman v. Lincoln Corp., 76 So.2d 478 (Fla. 1954). See also Note, Restraints on Alienation of Stock Certificates, 8 FLA. L. REV. 321 (1955).
42. 1 WILLISTON, CONTRACTS § 45 (rev. ed. 1936).
43. It should be noted, too, that balance sheet values are subject to adjustment by the board of directors, thus leaving the selling or purchasing stockholder more or less at their mercy. See e.g., Drucklieb v. Harris, 209 N.Y. 211, 102 N.E. 599 (1913), wherein the agreed purchase price was "book value," but action by the directors reducing such book value by writing down the assets was held valid.
in the agreement, dissatisfaction and litigation are apt to result if the book value method is selected.

Capitalization of prior earnings as a criterion for evaluation of the shares of a business also presents practical difficulties. What particular period is to be selected? What is its duration? By whom are the annual earnings to be determined? By what method? These are troublesome questions. Moreover, if the enterprise is a growing one, it is likely that future earnings will not properly be reflected in any computation of prior earnings. Here again, if such a valuation method is used, the just discussed problems should be clearly defined and solved within the four corners of the agreement.

The selection of market value as a valuation method is appropriate if the shares are listed on an exchange or actively traded in the over-the-counter market.\[44\] The advantage of this method is obvious; an objectively fixed price for sale or purchase of the shares is, in effect, predetermined. If, however, the shares are unlisted and not actively traded, as is the case with most small and close corporations, there is no ready market and no market value in the arm’s length sense.

Finally, a valuation method that has enjoyed considerable popularity in recent years involves appraisal and arbitration. More specifically, the agreement, after specifying the manner in which appraisers or arbitrators are to be selected,\[45\] usually provides that if the arbitrators can agree on a price, that price shall be conclusive. In the event that the two arbitrators cannot agree, the agreement commonly provides that they shall choose a third party as umpire, and the decision of the majority shall fix a price.

In summation, the selection of a valuation method will depend upon the nature of the business and the character of its assets. The writer has found that a combination of the book value method and the arbitration method provides the most workable solution for the average small corporate business. For example, if book value is clearly defined, as suggested in the preceding discussion, that method can be effectively applied to tangible assets of the business, while the arbitration method can, at the same time, be applied to the company’s intangible assets such as good will.

As stated previously, the restrictive transfer agreement may provide that, before being disposed of to outsiders, the shares must first be offered either to the corporation or to the other shareholders. If the corporation is granted first refusal, the governing state statutes should be checked to ascertain whether the corporation is permitted to purchase its own

\[44\] On all active unlisted securities daily bid and asked prices may be obtained from the National Daily Quotation Sheets (“pink sheets”) published by the National Association of Securities Dealers.

\[45\] A suggested approach grants to each of the parties involved the right to appoint an arbitrator.
shares. Statutes throughout the country are not uniform in this respect, some limiting the purchase of shares from surplus,\(^{46}\) others permitting purchase from capital under certain restrictions. Some few states absolutely forbid corporations to purchase their own stock.\(^{47}\) The general rule may now be said to be that in the absence of any express statutory prohibitions, or restrictions against such purchases in the corporate charter or by-laws, every corporation has the power in good faith to purchase its stock out of surplus.

In addition, as between parties to the agreement, it is specifically enforceable. Since there is no readily available market, and in many instances no market at all, in which the corporation or other shareholders could purchase shares and then recover damages in a lawsuit, specific performance is the only adequate remedy. As stated in a leading case: "An action at law to recover damages for breach of the contract would not afford adequate remedy but, in effect, destroy the very purpose of the agreement by opening the way for holding of the stock by third persons."\(^{48}\)

V. PRE-EMPTIVE RIGHTS

Another control device to which serious attention should be given in draftsmanship during the organizational stage concerns pre-emptive rights. It is obvious that if the capital stock is increased by the authorization and issuance of new shares of the same class as that held by an organizer, the organizer's political position in the corporation will be placed in jeopardy in the absence of some protective device. Accordingly, statutes in most states expressly grant pre-emptive rights to corporate shareholders. Such rights entitle the original shareholders to subscribe to the new stock issue in preference to outsiders and on an equal basis with other original shareholders in proportion that the amount of shares owned or held by him bears to the total outstanding amount of such shares.\(^{49}\) It is to be noted that the language of the Florida statute limits the pre-emptive right to "the sale for cash . . . ."\(^{50}\) Stock issued for services or property, then, would not be subject to pre-emptive rights unless appropriate restrictions were included in the by-laws or in a separate stockholders agreement.\(^{51}\)

Legal problems, however, have, for the most part, arisen in connection with interpretation of that clause of the statute reading, "of any new stock

\(^{46}\) FLA. STAT. § 608.13 (1955).
\(^{47}\) For a complete review of statutes and decisions, see 6A FLETCHER, CORPORATIONS §§ 2845-2861 (perm. ed. 1950).
\(^{49}\) FLA. STAT. § 608.42 (1955).
\(^{50}\) Ibid.
\(^{51}\) If either of these methods is used, proper reference should be placed upon the stock certificates. See discussion concerning restrictive transfer agreements supra...
of the same kind, class or series as that which he already holds." First of all, what is meant by "new" stock? Does the word "new" refer only to newly authorized and issued stock or also to previously authorized but newly issued stock? Cases in other jurisdictions are in hopeless conflict on this point.\(^2\) In \textit{Rowland v. Times Publishing Co.}\(^3\), the directors sold previously authorized but unissued shares to certain minority shareholders for the purpose of giving them control to the exclusion of a majority shareholder. In holding this transaction invalid and subject to cancellation in equity, the Supreme Court of Florida, in effect, extended pre-emptive right protection to new issues of originally authorized shares.\(^4\)

Next, the words, "same kind, class or series as that which he already holds" have caused considerable interpretative difficulties. Is a holder of common shares entitled to pre-emptive rights, for example, on the new authorization or issuance of preferred shares? The above statutory language would seem to give a clear negative answer. Suppose, however, that Mr. A holds voting common shares of XYZ, Inc. Is he entitled to pre-emptive right protection on the new authorization or issuance of non-voting common shares of YXZ, Inc.? True, he does hold the same "kind" of shares (common), although not the same "class." Yet, his political position is in no way weakened by issuance of non-voting common shares.\(^5\)

Once the corporate attorney has the objective of the proposed organization clearly in mind, these problems of statutory construction can be avoided by careful draftsmanship of the by-laws. Any pre-emptive right restrictions which are included in the by-laws, however, should be properly referred to on the stock certificate.\(^6\)

Finally, it should be noted that pre-emptive rights may be denied altogether if an appropriate provision to that effect is included in the certificate of incorporation.\(^7\) In some instances this procedure may be advisable. Suppose, for example, that a public offering of securities is contemplated. Compliance with pre-emptive rights provisions may hinder or delay the offering. In general, underwriters of a public issue will not take

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53. 160 Fla. 465, 35 So.2d 399 (1948).

54. While it is true that this case was decided under former FLA. STAT. §§ 612.20, 612.26 (1955), the words "new stock" have not been changed by amendment. FLA. STAT. § 608.42 (1955).

55. This troublesome question has been answered in different ways. See Frey, \textit{Shareholders' Pre-emptive Rights}, 38 YALE L.J. 563, 577 (1929).

56. See FLA. STAT. § 614.17 (1955) and note 51 supra.

57. FLA. STAT. § 608.42 (1955).
kindly to pre-emptive rights provisions, but may insist that such rights be waived before the underwriting is commenced.\textsuperscript{58}

\textbf{Conclusion}

The practice of corporate law involves a maximum of precise and practical draftsmanship, within the framework of existing statutes, rules, regulations and court decisions. It is the sincere hope of the writer that attorneys, especially those attorneys to whom the practice of corporate law is new, will in some way be benefited by this article and an application of its principles.

\footnote{\textsuperscript{58}Such a waiver would first have to be approved by shareholders whose rights were adversely affected. See \textit{Fla. Stat.} \S 608.18 (1955).}