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CORPORATIONS - EQUITABLE INTERVENTION IN CORPORATE AFFAIRS - MEANING OF "INTERNAL MANAGEMENT"

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CORPORATIONS — EQUITABLE INTERVENTION IN CORPORATE AFFAIRS — MEANING OF "INTERNAL MANAGEMENT" — In a recent case before the Court of Appeals of Maryland, *Williams v. Salisbury Ice Co.*,[1] a minority stockholder who had met with defeat in a prior struggle over the control of the defendant, a domestic corporation, filed a bill of complaint asking for the appointment of a receiver to manage the corporation until the rights of creditors and stockholders could be "permanently preserved." It appeared that one Meeker, who was the virtual owner of a competing ice company, had acquired ownership of a majority of the defendant corporation's stock. The defendant was solvent, but the plaintiff's chief source of complaint was that the defendant's retail ice business had been sold to the competing company at a grossly inadequate price. The evidence did not support this contention and the upper court affirmed the circuit court's decree dismissing the bill. Inter alia, the court observed:

[1] (Md. 1939) 3 A. (2d) 507.

"In a word, if the question involved is one concerning the internal management of corporate affairs, void of acts ultra vires, fraudulent or illegal, courts of equity will refrain from granting relief to a minority stockholder. . . ."[2]

The term "internal management," as used in the sense found above, is not a newcomer in legal nomenclature.[3] Despite its frequent appearance in the reports, however, there has been a paucity of discussion in the cases and among legal writers as to the precise meaning of the words. The frequent utilization of the term raises the question of whether or not it has any exact legal significance. An examination of the decisions dealing with the problem of equitable intervention in corporate affairs at the instance of a minority stockholder discloses at least three distinctly different meanings that have been given to the term.

The broadest and most inclusive meaning is that any act of a corporation in so far as it affects the corporation's relationship with any of its stockholders is a matter of "internal affairs." This definition is most often found in the cases where the court is asked to intervene in the affairs of a foreign corporation. The general rule is said to be that an equity court has no visitorial powers over foreign corporations and has no power to interfere in the internal affairs of such corporations.[4] Although the term has been said to have no very definite or fixed meaning,[5] the Maryland court in an early case[6] essayed a definition which has often been adverted to by later decisions. In discussing the distinction between acts which relate to internal management and those which do not, the court said:

"But we apprehend the distinction to be this: That where the act complained of affects the complainant solely in his capacity as a member of the corporation, whether it be as stockholder, director, president, or other officer, and is the act of the corpora-

[2] Ibid., at p. 513.

[3] The term has long been used in this country in cases where an equity court is asked to intervene in the affairs of a foreign corporation. See: Howell v. Chicago & Northwestern Ry., 51 Barb. (N. Y.) 378 (1868). A leading case which seems to have popularized the words is MacDougall v. Gardiner, 1 Ch. D. 13 (1875).

[4] Rogers v. Guaranty Trust Co., 288 U. S. 123, 53 S. Ct. 295 (1933); Hoglan v. Moore, 219 Ala. 497, 122 So. 824 (1929); Fox v. Pathe Exch., 106 N. J. Eq. 522, 151 A. 463 (1930); Nat. Guarantee Credit Corp. v. Worth & Co., 274 Pa. 148, 117 A. 914 (1922); Turner v. Goetz, 184 Wis. 508, 199 N. W. 155 (1924). See annotations on this subject in 18 A. L. R. 1383 (1922); 32 A. L. R. 1353 (1924); and 89 A. L. R. 736 (1934).

[5] Edwards v. Schillinger, 245 Ill. 231, 91 N. E. 1048 (1910).

[6] North State Copper & Gold Mining Co. v. Field, 64 Md. 151, 20 A. 1039 (1885).

> tion, whether acting in stockholders' meeting, or through its agents, the board of directors, that then such action is the management of the internal affairs of the corporation, and in case of a foreign corporation our Courts will not take jurisdiction. Where, however, the act of the foreign corporation complained of affects the complainant's individual rights only, then our courts will take jurisdiction, whenever the cause of action arises here."[7]

While this meaning of the words is not universally accepted, it has been adopted by several courts.[8] The impracticability of attempting to determine equitable jurisdiction on the basis of whether or not the matter in question is one of "internal management" is abundantly illustrated by those cases dealing with foreign corporations. A common practice is to state the general rule without undertaking to explain the language, and then say that the act in controversy is not a matter of internal management within the meaning of the rule.[9]

It is believed that many courts dealing with domestic corporations tacitly adopt this definition of the term. The usual mode of expression is to say that the court will not interfere with the internal management at the instance of a minority stockholder, except where the majority are performing ultra vires, fraudulent, or illegal acts. That is to say, even an ultra vires act is an "internal" matter because it involves the relationship between a corporation and one of its stockholders, but the jurisdiction of the court is invoked under an exception to the general rule.[10] It was in this sense that the Maryland court apparently was using the expression in the *Salisbury Ice Co.* case.

[7] Ibid., 64 Md. at 154.

[8] For a complete list of cases which have cited the Maryland court's definition approvingly, see 18 A. L. R. 1383 at 1390 (1922). The fundamental changes in the principles involved in that phase of equitable jurisdiction are beyond the scope of this inquiry, but it should be pointed out that it is doubtful whether many courts today would subscribe literally to that meaning of "internal management."

[9] Guilford v. Western Union Telegraph Co., 59 Minn. 332, 61 N. W. 324 (1894). A slightly different tack was adopted in the case of Tasler v. Peerless Tire Co., 144 Minn. 150, 174 N. W. 731 (1919). Here the court listed certain things which it thought were internal affairs. The court said, 144 Minn. at 153: "They [courts of Minnesota] have no jurisdiction to interfere with their [foreign corporations'] 'internal management,' that is, they could not enforce forfeiture of charter, nor removal of officers, nor could they exercise authority over corporate functions, nor direct the manner of the transaction of the corporate business." It is doubtful whether any attempt to define the term in such a manner is satisfactory, and this is particularly true where, as here, the items are couched in such general language as to be of little practical assistance in any attempt to find out just what is meant by "internal management."

[10] 6 THOMPSON, CORPORATIONS, 3d ed., § 4506 (1927). In MacDougall v. Gardiner, 1 Ch. D. 13 at 21 (1875), the court says: "that is to say, that nothing connected with the internal disputes between the shareholders is to be made the subject

The second meaning of the term is that any intra vires act of a corporation, regardless of how fraudulent or unfair it may be, is a matter of "internal management." Obviously, this does not mean that the equity court will in no instance interfere with intra vires acts of a corporation, but only that such intervention is an exception to the rule of non-interference with internal management. In other words, the court may concede that the act over which the dispute has arisen is an internal affair because it is intra vires, but afford relief because the act was a fraud on the rights of the minority stockholder. The New York Court of Appeals has stated it in this way:

> "As a general rule courts have nothing to do with the internal management of business corporations. . . . Corporate elections furnish the only remedy for internal dissensions, as the majority must rule so long as it keeps within the powers conferred by the charter.
>
> "To these general rules, however, there are some exceptions, and the most important is that founded on fraud."[11]

It is generally accepted today that an equity court can interfere if the majority stockholders are forcing the corporation to commit ultra vires acts.[12] Hence when the New York court said that it would not interfere with the internal management of a corporation unless there was fraud, it must have meant that any intra vires act of a corporation is a matter of internal management. This conception of the term found expression in an Alabama case,[13] which quoted a well-known treatise on corporation law[14] as follows: "*Intra vires* acts are frequently spoken of as matters concerning the 'internal management' of the corporation." The court went on to say that employment by the defendant corporation of a physician to look after the health of the organization's employees was an intra vires act, and thus a matter of internal management. This meaning of the term is also to be found in a Georgia statute, which provides:

> "So long as the majority of stockholders confine themselves within the charter powers, a court of equity will require a strong

of a bill by some one shareholder on behalf of himself and others, unless there be something illegal, oppressive, or fraudulent—unless there is something *ultrà vires* on the part of the company *quâ* company, or on the part of the majority of the company, so that they are not fit persons to determine it." Also see: Becher v. Wells Flouring Mill Co., (C. C. Minn. 1880) 1 F. 276.

[11] Flynn v. Brooklyn City Rd. Co., 158 N. Y. 493 at 507, 53 N. E. 520 (1899).

[12] 13 FLETCHER, CYCLOPEDIA CORPORATIONS, perm. ed., § 5823 (1932); 4 THOMPSON, CORPORATIONS, 3d ed., § 2906 (1927); 3 COOK, CORPORATIONS, 8th ed., § 669 (1923).

[13] Jackson Lumber Co. v. Trammell, 199 Ala. 536, 74 So. 469 (1917).

[14] 3 COOK, CORPORATIONS, 8th ed., § 683 (1923).

case of mismanagement or fraud before it will interfere with the internal management of affairs of a corporation." [15]

A third and more uncommon meaning sometimes attached to the words is that any act which the majority stockholders may confirm is a matter of "internal management." [16] Whether the action is one which the majority in interest among the stockholders may confirm will depend upon whether or not the chancellor rules that the complaining minority stockholder should be given relief in the particular case at bar. When used in this manner, the term is merely a short-cut statement of a conclusion, namely, that the complainant is not to be granted equitable relief. Such a use of the term may be justifiable, but a court doing so should pick its language carefully in order to avoid the error of indiscriminately using the words in one of the other two more common methods in the same context. The point can be illustrated by reference to another Maryland case. [17] The court said:

> "Mere internal dissentions [*sic*] among stockholders, or mere differences or disputes as to corporate management, so long as the officers do no act that is fraudulent, illegal or *ultra vires*, will not warrant the intervention of a Court of Chancery, because in the absence of fraud, illegality or conduct that is *ultra vires*, the will of the majority is entitled to control the policy and the business of the body corporate."

Then the court proceeded to say that the failure of the appellant to be re-elected as a director of the corporation was only "a matter of internal corporate management." [18] What did this court mean by "internal" affairs? Is any act concerning the relations between the corporation and the appellant-stockholder an act of "internal" concern and challengeable only if it is ultra vires, fraudulent or illegal? Or did the court mean that any act is "internal" when it involves an act of the corporation which the majority of the stockholders may approve? It is evident that the court started out using the term in one sense and ended up by saying, in effect, that anything is internal management with which the court has decided it will not interfere.

It appears that if the words have any legal significance at all, they mean (1) any relationship between a stockholder and his corporation

[15] Ga. Code Ann. (1936), § 22-710.

[16] 3 COOK CORPORATIONS, 8th ed., § 683 (1923). Also see Symmes v. Union Trust Co., (C. C. Nev. 1894) 60 F. 830, where the court started with the premise that the majority stockholders may confirm all acts done in the name of the corporation, except those which are ultra vires or fraudulent. The court then said that any intra vires act which is free from fraud is an act of internal management.

[17] Howeth v. Coulbourne Bros., 115 Md. 107 at 117, 80 A. 916 (1911).

[18] Ibid., 115 Md. at 118.

or those acting for it, or (2) any intra vires act of a corporation, or (3) any act done in the name of the corporation which the majority stockholders may confirm. The diversity of definitions might be attributed to the increasing willingness of equity courts to interfere with the management of a corporation on the petition of a minority stockholder.[19] At a time when an equity court would not accept jurisdiction over a controversy arising between a corporation and one of its stockholders,[20] or when the court would interfere only if a given act of a corporation was ultra vires,[21] the term might have been useful as a test of equitable jurisdiction. No modern-day chancellor, however, would refuse relief against action of a corporation dominated by the majority stockholders on either of those two grounds alone.[22] It therefore seems manifest that the term is of no aid in determining the power of an equity court to intervene in corporate disputes; neither does it serve any useful purpose in determining the propriety of such intervention. If the first mentioned definition is adopted, and it was in that sense which the court in the *Salisbury Ice Co.* case presumably used the words, the exceptions resulting from the modern expansion of equitable jurisdiction over corporate affairs appear to have completely abrogated the doctrine of non-interference in internal management. The same is true to a somewhat lesser degree if the second definition is accepted. It is suggested that the rule as stated in the *Salisbury Ice Co.* case is, for all practical purposes, meaningless. The real inquiry is not as to whether the act or acts complained of are matters of "internal management," but whether they are ultra vires, or fraudulent, or so unfair to the minority stockholder that the court will not allow the majority to confirm them.[23] Any reference to "internal management" is superfluous if not actually misleading.

Henry L. Pitts

[19] For a summary of the extent of and reasons for the increasing concern of equity with corporate affairs and the relationship between stockholders, see Simpson, "Fifty Years of American Equity," 50 HARV. L. REV. 171 at 190 et seq. (1936).

[20] Latimer v. Eddy, 46 Barb. (N. Y.) 61 (1864). At page 67 is found the following statement: "and the general principle is, that a court of equity has no visitorial power over corporations, except such as may be expressly conferred on it by statute."

[21] 13 FLETCHER, CYCLOPEDIA CORPORATIONS, perm. ed., §§ 5823-5828 (1932), and cases cited therein.

[22] The extent of present-day equitable control over corporate disputes is ably described by Rohrlich, "Suits in Equity by Minority Stockholders as a Means of Corporate Control," 81 UNIV. PA. L. REV. 692 (1933). Also see: Lattin, "The Minority Stockholder and Intra-Corporate Conflict," 17 IOWA L. REV. 313 (1932); and a comment in 32 MICH. L. REV. 839 (1934).

[23] While Maryland seems to be committed to the strict rule denying that stockholders are trustees for each other, the majority of courts appear to follow the view expressed by Justice Brandeis in Southern Pac. Co. v. Bogert, 250 U. S. 483, 39

S. Ct. 533 (1919); namely, when the majority assume to act for the corporation they become fiduciaries for the minority stockholders. Therefore, under the majority rule, a minority stockholder should be able to secure equitable relief without showing an act of the majority to be absolutely ultra vires or fraudulent. It has been suggested that all acts of a corporation should be subject to the latter rule on the theory that corporate powers are powers in trust. See: Berle, "Corporate Powers as Powers in Trust," 44 HARV. L. REV. 1049 (1931); BERLE, STUDIES IN THE LAW OF CORPORATION FINANCE 46 et seq. (1928).