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# CORPORATIONS - DISSOLUTION AT SUIT OF A MINORITY STOCKHOLDER

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CORPORATIONS — DISSOLUTION AT SUIT OF A MINORITY STOCKHOLDER — The general statement has often been made that a court of equity has no power to dissolve a solvent corporation at the suit of a minority stockholder, in the absence of special statutory authority.[1] However, some of the cases which seem to support this rule hedge considerably by saying that "ordinarily" or "generally" equity has no such jurisdiction.[2] These cases would seem little different than those which hold that a court of equity has inherent jurisdiction to dissolve a corporation but will exercise it only in cases of extreme necessity.[3] The latter seems to be the prevailing view and on principle the best.[4]

The rationale generally given to the position that equity is entirely without such jurisdiction is that, since a corporation may come into existence only through an act of the state, the state alone, through proceedings by its officers, should have the power to dissolve it.[5] That this does not indicate the true attitude of the legislatures would seem apparent by the statutory provisions for voluntary dissolution by the vote of a majority, or greater percentage, of the stock.[6] With the change from corporations formed by special charters to corporations formed under general acts, this position has lost much of its appeal to the courts,[7] some saying that equity's jurisdiction to dissolve corporations is the same as its jurisdiction to dissolve partnerships.[8]

[1] See cases cited in annotations, 43 A. L. R. 242 at 288 (1926); 61 A. L. R. 1212 at 1221 (1929); 91 A. L. R. 665 at 676 (1934). It is to be noted that in some of the cases cited throughout this comment, the relief sought was not dissolution but the appointment of a receiver to wind up the affairs of the corporations and distribute the assets. However, the general view is that such relief is tantamount to dissolution. Ulmer v. Maine Real-Estate Co., 93 Me. 324, 45 A. 40 (1899); Sidway v. Missouri Land & Live Stock Co., (C. C. Mo. 1900) 101 F. 481. There is some authority for the reverse proposition, see Schneider v. Schneider, 347 Mo. 102, 146 S. W. (2d) 584 (1940). In the cases cited in this comment the courts considered the two kinds of relief as synonomous.

[2] Town v. Duplex-Power Car Co., 172 Mich. 519, 138 N. W. 338 (1912). Thwing v. McDonald, 134 Minn. 148, 156 N. W. 780, 158 N. W. 820, 159 N. W. 564 (1916).

[3] Arcola Sugar Mills Co. v. Burnham, (C. C. A. 5th, 1933) 67 F. (2d) 981, reversing (D. C. Tex. 1932) 2 F. Supp. 738; Manufacturers' Land & Improvement Co. v. Cleary, 121 Ky. 403, 89 S. W. 248 (1905).

[4] See cases cited in annotations, 43 A. L. R. 242 at 296 (1926); 61 A. L. R. 1212 at 1222 (1929); 91 A. L. R. 665 at 677 (1934).

[5] Feess v. Mechanics' State Bank, 84 Kan. 828, 115 P. 563 (1911).

[6] On voluntary dissolution, see 16 FLETCHER, CYCLOPEDIA CORPORATIONS, perm. ed., §§ 8006-8033 (1942).

[7] Goodwin v. Van Cotzhausen, 171 Wis. 351, 172 N. W. 618 (1920).

[8] Green v. National Advertising & Amusement Co., 137 Minn. 65, 162 N. W. 1056 (1917); Brent v. B. E. Brister Saw Mill Co., 103 Miss. 876, 60 So. 1018 (1913).

But, conceding that equity has jurisdiction, there is still good reason in most cases for denying the minority stockholder relief. By becoming a member of the corporation the stockholder impliedly agrees that the corporate affairs and assets shall be handled according to the dictates of the majority acting through the directors.[9] Therefore, if an individual stockholder disapproves of the manner in which the corporate affairs are being managed his only remedies are to seek the election of new directors or to sell his stock.[10] However, such an answer will not satisfactorily dispose of the petition for dissolution when the corporation is not fulfilling its obligations to the stockholder. In such cases the tendency seems to be to allow the stockholder to maintain his bill for dissolution if his interests can be protected in no other way.[11] Such a statement is too general to be of much value, however. Actually the courts deal with the problem in terms of several very definite types of fact situations.

I.

Dissolution has been granted when the corporation has been abandoned by its stockholders and no longer carries out its corporate functions.[12] In such a case it cannot be said that the stockholder, when he became a member, agreed to that of which he now complains. He invested his money with the understanding that it was to be used in a going concern, and when the corporation ceases to be such it is under a duty to the stockholder to dissolve and distribute the remaining assets.[13] Nor is there any way in which he may protect his investment by proceeding through corporate channels because, with the corporation's abandonment, stockholders' meetings become impossible. The

[9] Weisert v. Kraft, 209 Ky. 741, 273 S. W. 462 (1925); Phinizy v. Anniston City Land Co., 195 Ala. 656, 71 So. 469 (1916).

[10] Benedict v. Columbus Construction Co., 49 N. J. Eq. 23, 23 A. 485 (1891); O'Conner v. Knoxville Hotel Co., 93 Tenn. 708, 28 S. W. 308 (1894).

[11] See Stott Realty Co. v. Orloff, 262 Mich. 375, 247 N. W. 698 (1933), where dissolution was sought on the grounds of mismanagement. The petition was denied for the reason that equity could afford adequate relief by the less drastic means of enjoining the misconduct. In Ulmer v. Maine Real-Estate Co., 93 Me. 324, 45 A. 40 (1899), where dissolution was sought on grounds of mismanagement by illegally elected directors, the relief was denied, the court suggesting that plaintiff should first try to have the directors ousted at a stockholders' meeting and if this failed bring a representative suit in equity. See also Arcola Sugar Mills Co. v. Burnham, (C. C. A. 5th, 1933) 67 F. (2d) 981, reversing (D. C. Tex. 1932) 2 F. Supp. 738.

[12] Noble v. Gadsden Land & Improvement Co., 133 Ala. 250, 31 So. 856 (1901); Central Land Co. v. Sullivan, 152 Ala. 360, 44 So. 644 (1907).

[13] Franklin National Bank v. Kennerly Coal & Coke Co., 300 Pa. 479, 150 A. 902 (1930).

importance of this last factor is shown by the fact that inability to hold a stockholders' meeting has been made the test of abandonment.[14]

2.

Dissolution may also be decreed at the suit of a stockholder when the corporate purpose has become impossible, even though the corporation is still solvent and may be termed a going concern.[15] Under such circumstances there can be no question that if the corporation continues it will violate its obligations to the stockholder.[16] He invested his money with the understanding that it should be used in accomplishing a certain purpose, and the corporation is under a duty to see that it is so used. However, there is much difficulty in making the necessary factual showing for relief on these grounds.

Ordinarily the purpose of the corporation is to make money and when there is no longer any possibility of this, the stockholder is entitled to dissolution.[17] But the courts are very reluctant to substitute their business judgment for that of the directors or majority stockholders.[18] If the directors or majority stockholders do not institute proceedings looking toward voluntary dissolution, it would seem that they consider it probable that the business may still be conducted profitably. In most cases this factor will be controlling in denying the prayer for dissolution.[19] To overcome this the stockholder will have to show either that the majority is acting fraudulently in keeping the corporation alive so as to promote the majority's interests at the expense of the minority,[20] or that the impossibility of successful operation is so certain that the majority is acting arbitrarily in continuing the corporate

[14] See Noble v. Gadsden Land & Improvement Co., 133 Ala. 250, 31 So. 856 (1901), in which the court, in allowing the relief, emphasized the fact that the directors had made several unsuccessful attempts to hold stockholders' meetings. In Central Land Co. v. Sullivan, 152 Ala. 360, 44 So. 644 (1907), it was alleged that there had been no stockholders' meetings for five years, and relief was allowed. On rehearing it was shown that a meeting outside the state had been held during this time. Though this meeting was illegal it was held sufficient to show that the corporation was not abandoned and therefore the former decree was reversed. Sullivan v. Central Land Co., 173 Ala. 426, 55 So. 612 (1911).

[15] See cases cited in annotations, 43 A. L. R. 242 at 305 (1926); 61 A. L. R. 1212 at 1223 (1929); and 91 A. L. R. 665 at 679 (1934).

[16] Brent v. B. E. Brister Saw Mill Co., 103 Miss. 876, 60 So. 1018 (1913).

[17] Kroger v. Jaburg, 231 App. Div. 641, 248 N. Y. S. 387 (1931).

[18] Graham-Newman Corp. v. Franklin County Distilling Co., (Del. Ch. 1942) 27 A. (2d) 142; Manufacturers Land & Improvement Co. v. Cleary, 121 Ky. 403, 89 S. W. 248 (1905); Stockholders of Jefferson County Agr. Assn. v. Jefferson County Agr. Assn., 155 Iowa 634, 136 N. W. 672 (1912); Stott Realty Co. v. Orloff, 262 Mich. 375, 247 N. W. 698 (1933); Phinizy v. Anniston City Land Co., 195 Ala. 656, 71 So. 469 (1916).

[19] See cases cited in note 12, supra.

[20] Kroger v. Jaburg, 231 App. Div. 641, 248 N. Y. S. 387 (1931); Gettinger v. Heaney, 220 Ala. 613, 126 So. 195 (1930).

existence. Some cases hold that there must be a showing that continued operation will lead to inevitable ruin.[21] This seems only another way of stressing the certainty with which impossibility must be shown. But in any event the requirement does not appear to add much because it is difficult to conceive of a situation in which profitable operations are impossible, but continuation will not ultimately lead to insolvency. Be this as it may, it is not surprising that there are few cases granting relief on the grounds that further profitable operations are impossible, independent of a showing of fraud or mismanagement.[22]

In some cases the corporate purpose becomes impossible in a different sense. Thus legislation may be passed making the business for which the corporation was organized illegal.[23] And it is conceivable that it might become impossible to carry on the corporate business for some other reason.[24] Under such circumstances the corporation will unquestionably violate its obligation to the stockholder by continuing. But here, too, the question arises—if the corporate purpose is truly impossible, and the majority is not acting fraudulently, why have not proceedings for voluntary dissolution been instituted? This is probably due to the very strong showing of impossibility required before the stockholder will succeed in a suit for dissolution on such grounds.[25] There is another consideration in these cases. If the majority can legally make such changes in the nature of the business as to remove the impossibility, then the minority stockholder would have no basis for seeking dissolution because the corporation would be violating no obligation to him by continuing in the altered business.[26]

[21] Dixie Lumber Co. v. Hellams, 202 Ala. 488, 80 So. 872 (1919); Stott Realty Co. v. Orloff, 262 Mich. 375, 247 N. W. 698 (1933).

[22] See O'Conner v. Knoxville Hotel Co., 93 Tenn. 708, 28 S. W. 308 (1894), which seems to be such a case although there is some indication of abandonment.

[23] Hall v. City Park Brewing Co., 294 Pa. 127, 143 A. 582 (1928).

[24] See the later section of this comment concerning dissensions as a ground for dissolution.

[25] See Benedict v. Columbus Construction Co., 49 N. J. Eq. 23, 23 A. 485 (1891), in which a minority stockholder brought a bill in a New Jersey court for the dissolution of a corporation whose purpose was to construct a pipeline from Indiana to Chicago, his theory being that this purpose had been made impossible by an Indiana statute which made such pipelines illegal. The court denied relief on the grounds that, in a proper proceeding the statute would probably be declared invalid as contrary to the commerce clause of the Federal Constitution.

[26] There seems to be no case directly involving this point, but Arcola Sugar Mills Co. v. Burnham, (C. C. A. 5th, 1933) 67 F. (2d) 981, appears to be good authority for the proposition. There the corporation, whose purpose was the growing and manufacturing of sugar, had given this up, apparently because it was not profitable, and had turned to the raising of cotton and other crops. The court refused the minority stockholders' prayer for dissolution, giving as one of its reasons that the majority stockholders could amend the charter to provide for the general farming business being conducted.

Before seeking dissolution on the ground that the corporate purpose has become impossible in either of the above senses, the minority stockholder must first seek relief through corporate channels. Demands must be made upon the directors[27] or upon the majority stockholders,[28] depending on which body is competent to give redress. There is also authority for the proposition that the minority stockholder suing for dissolution must join all the other stockholders,[29] at least if it is practical to do so.[30]

3.

Fraud and mismanagement on the part of the officers may provide grounds for a decree of dissolution at the suit of a minority stockholder.[31] In such circumstances it is obvious that the corporation is not fulfilling its obligations to the stockholders.[32]

The greatest obstacle to dissolution under these conditions is the possibility that the stockholder's interests may be amply protected by some less drastic form of relief. Thus it has sometimes been deemed sufficient to enjoin the misconduct.[33] In other cases the court has removed the offending officers,[34] although the power of a court of equity to do this is by no means settled.[35] Relief has also been afforded by appointing a temporary receiver to manage the corporate affairs until new officers can be elected.[36] This also would seem to involve the question of a court of equity's power to remove corporate officers. By the great weight of authority, equity may appoint a receiver only when the receiver is ancillary to some other type of relief and not when the

[27] Ross v. American Banana Co., 150 Ala. 268, 43 So. 817 (1907); Decatur Land Co. v. Robinson, 184 Ala. 322, 63 So. 522 (1913).

[28] Ulmer v. Maine Real-Estate Co., 93 Me. 324, 45 A. 40 (1899).

[29] Ross v. American Banana Co., 150 Ala. 268, 43 So. 817 (1907).

[30] Decatur Land Co. v. Robinson, 184 Ala. 322, 63 So. 522 (1913).

[31] Miner v. Belle Isle Ice Co., 93 Mich. 97, 53 N. W. 218 (1892); Green v. National Advertising & Amusement Co., 137 Minn. 65, 162 N. W. 1056 (1917); Goodwin v. Von Cotzhausen, 171 Wis. 351, 177 N. W. 618 (1920). *Contra*: Taylor v. Decatur Mineral & Land Co., (C. C. Ala. 1901) 112 F. 449; State ex rel. Donnell v. Foster, 225 Mo. 171, 125 S. W. 184 (1910).

[32] See Green v. National Advertising & Amusement Co., 137 Minn. 65, 162 N. W. 1056 (1917), which, like many of the cases, speaks of this in terms of the fiduciary duty of the majority stockholders.

[33] Mason v. Supreme Court of Equitable League of Baltimore City, 77 Md. 483, 27 A. 171 (1893); Platner v. Kirby, 138 Iowa 259, 115 N. W. 1032 (1908).

[34] Thwing v. McDonald, 134 Minn. 148, 156 N. W. 780, 158 N. W. 820, 159 N. W. 564 (1916); State ex rel. American Lead & Baryta Co. v. Dearing, 184 Mo. 647, 84 S. W. 21 (1904).

[35] Neall v. Hill, 16 Cal. 145 (1860); Tri-City Electric Service Co. v. Jarvis, 206 Ind. 5, 185 N. E. 136 (1933).

[36] Brennan v. Rollman, 151 Va. 715, 145 S. E. 260 (1928).

appointment of the receiver is the sole relief sought.[37] Thus it would seem that the receiver could not be appointed merely to run the business until new officers were elected according to the regular mode of procedure prescribed by the charter, but that the court would also have to remove the corrupt officers and provide for the election of their successors.[38]

But apart from such considerations it is doubtful that any of these forms of relief can adequately protect the minority stockholder when the majority stockholders are participating in the fraud themselves, or, more accurately, when the officers are engaged in their fraudulent conduct for the benefit of the majority stockholders and at the instigation of the majority. Under such circumstances it will be impossible to get honest directors no matter how many elections are held.[39] And relief by injunction will be just as unsatisfactory because it will require the minority stockholders to maintain ceaseless vigilance for further wrongful activities, and will probably also require frequent interventions by the court if the minority is to be adequately protected.[40] Therefore it may be said that dissolution should be granted on the grounds of fraud or mismanagement when, and only when, the fraud and mismanagement occurs at the instigation of, and for the benefit of, the majority stockholders.

Some of the cases also seem to indicate that in order to make out a case for dissolution there must be a showing that the fraud and mismanagement, if continued, will cause the ruin of the corporation.[41] While such is often the fact when the assets of the corporation are being diverted to the majority shareholders, this would not seem to be a logical prerequisite to the relief. Situations may be easily conceived in which the corporation is operating successfully but the minority stockholders are being fraudulently deprived of their just share of the returns in order wrongfully to enrich the majority. Under such circumstances it would seem that dissolution should be decreed.[42]

The stockholder need not seek relief from the directors or from the stockholders before bringing his suit for dissolution when his complaint is fraud and mismanagement, since such requests would obviously be of no avail.[43]

[37] Myers v. Occidental Oil Corp., (D. C. Del. 1923) 288 F. 997; Hitchcock v. American Pipe & Construction Co., 89 N. J. Eq. 440, 105 A. 655 (1918).

[38] This was done in Brennan v. Rollman, 151 Va. 715, 145 S. E. 260 (1928).

[39] Morse v. Metropolitan Steamship Co., 87 N. J. Eq. 217, 100 A. 219 (1917); Miner v. Belle Isle Ice Co., 93 Mich. 97, 53 N. W. 218 (1892).

[40] Riley v. Callahan Mining Co., 28 Idaho 525, 155 P. 665 (1916).

[41] Brennan v. Rollman, 151 Va. 715, 145 S. E. 260 (1928); Brent v. B. E. Brister Saw Mill Co., 103 Miss. 876, 60 So. 1018 (1913).

[42] Sellman v. German Union Fire Ins. Co., (C. C. Del. 1909) 184 F. 977.

[43] Miner v. Belle Isle Ice Co., 93 Mich. 97, 53 N. W. 218 (1892); Sant v. Perronville Shingle Co., 179 Mich. 42, 146 N. W. 212 (1914).

4.

Many of the cases indicate that serious dissensions between evenly divided factions of stockholders may afford grounds for a decree of dissolution at the suit of a minority stockholder.[44] However, it is doubtful whether such dissensions can be considered as an independent basis for the relief.

In many of the cases the dissensions are accompanied by fraud. For example, in at least two cases[45] the stockholders were split into two equal factions, each holding fifty per cent of the stock. The faction in control could not be dislodged and was diverting the profits and corporate assets to its members. In such a case, the fraud alone would seem a sufficient reason for granting dissolution at the suit of the aggrieved shareholders. Furthermore, it has been held that the exclusion of one equal faction from any voice in the management of the corporation is not a sufficient basis for dissolution in the absence of a showing of fraud or mismanagement on the part of the faction in control, providing, of course, that the exclusion is not contrary to the provisions of the charter or otherwise illegal.[46]

In the other cases where dissolution has been decreed because of dissensions, the latter have been of such a nature as to make further operation of the corporation impossible. Thus it may be that the dissensions make it impossible to elect a board of directors.[47] In these cases dissolution should be granted but the real reason would seem to be that it has become impossible to accomplish the corporate purpose.[48] This conclusion finds support in the holding of at least one case, that dissensions of such a nature as to make the election of a board of directors impossible did not afford sufficient grounds for dissolution because the corporation was still operating successfully and there was no danger to the corporate assets.[49]

Dissensions, then, would seem not to be an independent ground for dissolution but rather a contributing element to the factual situation necessary for relief on one of the other grounds.

[44] See dicta in Morse v. Metropolitan Steamship Co., 87 N. J. Eq. 217, 100 A. 219 (1917); Hlawati v. Maeder-Hlawati Co., 289 Pa. 233, 137 A. 235 (1927).

[45] Green v. National Advertising & Amusement Co., 137 Minn. 65, 162 N. W. 1056 (1917); Graham v. McAdoo, 135 Ky. 677, 123 S. W. 260 (1909).

[46] Hawkins v. Foasberg, 178 Minn. 457, 227 N. W. 655 (1929).

[47] Bowen v. Bowen-Romer Flour Mills Corp., 114 Kan. 95, 217 P. 301 (1923).

[48] In the following cases dissolution was decreed because of dissensions that made impossible the accomplishment of the corporate purposes. Flemming v. Heffner & Flemming, 263 Mich. 561, 248 N. W. 900 (1933); Platner v. Kirby, 138 Iowa 259, 115 N. W. 1032 (1908).

[49] Cook v. Cook, 270 Mass. 534, 170 N. E. 455 (1930). The same general principle was also expressed in Olechny v. Thadeus Kosciuszko Society, 128 Conn. 534, 24 A. (2d) 249 (1942).

5.

A number of states have statutes dealing with the rights of a stockholder to maintain a suit for dissolution.[50] For the most part these statutes make few additions to the bases on which such relief may be granted. Almost all of them provide for dissolution in case of incurable dissensions which make continuance of the corporation unprofitable.[51] Likewise many of them provide for such relief when the corporate objects have failed, been abandoned, or have become wholly impractical.[52] A fewer number make provision for dissolution in case of fraud and mismanagement on the part of the directors or persons in control.[53] Some also have a "shotgun" provision to the effect that dissolution will be decreed when it will be beneficial to the stockholders' interests.[54]

In addition there are a number of statutes providing quite different grounds on which a stockholder may maintain a bill for dissolution. Under the Arizona statute a stockholder may seek dissolution because the corporation failed to appoint a statutory agent, or failed to file such appointment, or because the corporation violated a state law, or an order of the corporation commission.[55] In North Carolina such a suit may be brought on the grounds that the corporation has not paid a sufficient dividend for a specified period.[56] Under the West Virginia statute the stockholders' bill for dissolution is to be dealt with according to the "principles and usage of equity," but the majority can avoid dissolution by buying up the complainants' stock at a price to be determined by commissioners of the court if the parties cannot agree on a price.[57]

[50] Such statutes of one sort or another are to be found in Arizona, California, District of Columbia, Illinois, Louisiana, Massachusetts, Minnesota, North Carolina, Pennsylvania, Rhode Island, Washington, and West Virginia.

[51] Cal. Civ. Code (Deering, 1941), § 404; Ill. Stat. Ann. (Smith-Hurd, 1935), § 56.86; La. Gen. Stat. Ann. (Dart, 1939), §§ 1135, 1136; Mass. Laws Ann. (Michie, Supp. 1941), c. 155, § 50; Minn. Stat. (Mason, Supp. 1940), § 7492.48 (d); 15 Pa. Stat. Ann. (Purdon, 1938), § 2852-1107; Wash. Rev. Stat. (Remington, Supp. 1940), § 3803-50.

[52] D. C. Code (1940), § 29-701; La. Gen. Stat. Ann. (Dart, 1939), § 1135; Minn. Stat. (Mason, Supp. 1940), § 7492.48 (b); 15 Pa. Stat. Ann. (Purdon, 1938), § 2852-1107; Wash. Rev. Stat. (Remington, Supp. 1940), § 3803-50.

[53] Cal. Civ. Code, (Deering, 1941), § 404; Ill. Stat. Ann. (Smith-Hurd, 1935), § 157.86; Minn. Stat. (Mason, Supp. 1940), § 7492.48 (c); 15 Pa. Stat. Ann. (Purdon, 1938), § 2852-1107; R. I. Gen. Laws (1938), c. 116, § 57.

[54] Cal. Civ. Code (Deering, 1941), § 404; D. C. Code (1940), § 29-701; Wash. Rev. Stat. (Remington, Supp. 1940), § 3803-50.

[55] Ariz. Code (1939), § 53.307.

[56] N. C. Code, (Michie, 1935), § 1186.

[57] W. Va. Code (1937), § 3093.

Probably the most important changes made by the statutes concern the qualifications of the stockholder bringing the bill. Several require that the complainants own a certain percentage of the voting stock, usually about twenty or thirty per cent.[58] Some provide that, in order to maintain a suit for dissolution, the complainants must have owned their stock for a certain period of time, ranging from six months to two years.[59]

The chief value of these statutes is that, in many cases, they make it impossible for the courts to fall back on the proposition that a court of equity has no jurisdiction to dissolve a corporation at the suit of a stockholder.

It may be concluded that, in spite of the often repeated statements to the contrary, equity has a well-recognized power to dissolve a corporation at the instance of a stockholder. That this power is exercised in relatively few cases is to be explained by the fact that proper situations seldom arise. The power should not be exercised for the purpose of substituting the business judgment of the court for that of the corporation's directors, or to enable the minority to hamstring the lawful control of the majority. But in situations where the corporation is not fulfilling its obligations to the complaining stockholder, as in cases of abandonment, or failure of the corporate purpose, or incurable fraud and mismanagement, the courts should recognize this power and exercise it, in the absence of an equally effective but less drastic remedy.

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[58] D. C. Code (1940), § 29-701; La. Gen. Stat. Ann. (Dart, 1939), § 1136; Mass. Laws Ann. (Michie, Supp. 1941), c. 155, § 50; N. C. Code (Michie, 1935), § 1186; W. Va. Code (1937), § 3093.

[59] La. Gen. Stat. Ann. (Dart, 1939), § 1136; N. C. Code (Michie, 1935), § 1186.