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Revision of the North Carolina Statute's Corporate Deadlock Provisions

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With the tremendous growth in recent years in the use of the corporate form of doing business and the proliferation of "incorporated partnerships," there has been a recognition of the need for state corporation statutes to provide remedies other than dissolution for the deadlocked corporation. In 1971 a package of revisions to the North Carolina deadlock provision that was prepared by the Business Corporation Act Drafting Committee of the North Carolina General Statutes Commission to provide such alternatives was presented to the North Carolina General Assembly, but no action was taken on the proposals. These recommendations will again be presented to the 1973 General Assembly. This comment will evaluate these proposals and will discuss other alternatives to the existing law that could be employed.

Corporate deadlock results when the shareholders of a corporation are unable to elect directors as a result of a voting stalemate or when the board of directors is unable to take effective management action for the same reason. The traditional rule at common law was that a court of equity did not have the power to dissolve a deadlocked corporation. Corporations were viewed as creatures of the legislature, so that their charters could not be taken away by the courts without statutory authority. As a result, practically all the important commercial and industrial

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1Clifford, Survey of Recent Developments and Prospects for Change, in NORTH CAROLINA BAR ASS'N, INSTITUTE ON BUSINESS ORGANIZATIONS I-23 (1972) [hereinafter cited as Clifford].

2Clifford I-23.

3N.C. GEN. STAT. §§ 55-125(a)(1)-(2) (1965) provide:

(a) The superior court shall have power to liquidate the assets and business of a corporation in an action by a shareholder when it is established that:

1. The directors are deadlocked in the management of the corporate affairs and the shareholders are unable to break the deadlock, so that the business can no longer be conducted to the advantage of all the shareholders; or

2. The shareholders are deadlocked in voting power, otherwise than by virtue of special provisions or arrangements designed to create veto power among the shareholders, and for that reason have been unable at two consecutive annual meetings to elect successors to directors whose terms had expired...

416A W. FLETCHER, PRIVATE CORPORATIONS § 8016.1 (rev. 1962) [hereinafter cited as FLETCHER]. However, the principle that a court of equity was utterly without the power to dissolve a corporation upon deadlock was not fully settled. Professor Hornstein, for example, suggests that equity does have the inherent power to dissolve a corporation upon a deadlock, but that the dissolution statutes were passed to eliminate "qualms as to whether action can be taken in the absence of statute." 2 G. HORNSTEIN, CORPORATION LAW AND PRACTICE § 789 (1959) [hereinafter cited as HORNSTEIN].

5Note, Deadlock and Dissolution in Close Corporations, 45 IOWA L. REV. 767, 768 (1960).
states have enacted statutes specifically authorizing corporate dissolution in situations of deadlock in director or shareholder voting. Under the present North Carolina dissolution-upon-deadlock provision, section 55-125 of the North Carolina General Statutes, a court can order dissolution because of director deadlock if the suing shareholder can establish the stronger equities and prove (1) that the directors are deadlocked in the management of the corporate affairs, (2) that the shareholders are unable to break the deadlock, and (3) that because of the deadlock the business can no longer be conducted to the advantage of all the shareholders. A court can order dissolution because of shareholder deadlock if the suing shareholder can establish the stronger equities and prove (1) that the shareholders are deadlocked in voting power, (2) that the reason for the deadlock is not related to special arrangements designed to create veto power among the shareholders, and (3) that because of the deadlock the shareholders have been unable at two consecutive annual meetings to elect successors to directors whose terms have expired.

Dissolution of the corporation has been the traditional statutory response to the problem of deadlock. The North Carolina provision is patterned after the Model Business Corporations Act, and both it and the Model Act provide no alternative remedy for a deadlocked corporation.

THE NEED FOR REVISION OF THE DEADLOCK PROVISIONS

Apart from the fact that section 55-125 fails to provide a satisfactory remedy for many types of corporate deadlock situations, there are other problems that arise from the application of the statute. First, as mentioned above, to get dissolution because of director deadlock a petitioner must prove the stronger equities plus all the elements of subsection (a)(1) of section 55-125. Each of these three elements requires a factual determination that may often be very difficult to resolve.

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7 R. Robinson, North Carolina Corporation Law and Practice § 221, at 548 (1964) [hereinafter cited as Robinson].
9 Robinson § 221, at 548.
12 See text accompanying notes 7-8 supra.
13 Robinson § 221, at 548.
instance, "mere friction and surface dissension" may not justify dissolution, while dissolution would be called for in the face of a "fundamental and irreconcilable conflict amounting to a complete deadlock." The difference between "mere friction and surface dissension" on the one hand and "fundamental and irreconcilable conflict" on the other is largely undefinable and may be quite difficult to discern. Thus the statute fails to provide a court with an easily implemented standard for determining when a deadlock exists. Furthermore, the statute does not say when a business is to be considered as no longer being "conducted to the advantage of all the shareholders." This phrase may simply mean that if the corporation is making any profit at all no shareholder has the right to petition for dissolution because of deadlock. Alternatively, it may have been intended to set up a looser standard and to permit dissolution where, for example, dividends are not being paid at an optimum level or where certain shareholders are receiving greater benefits than others through exorbitant salaries.

Secondly, the North Carolina statute shares a problem with most other states' dissolution-upon-deadlock statutes in that the power of the court to grant dissolution is discretionary. The statute states that if the petitioner establishes the elements required, the superior court "shall have the power" to dissolve. But, like the statutes of most other states, the North Carolina statute fails to specify circumstances requiring the court to exercise its power. The courts of some states do say that when the prerequisites of the statute are met, the deadlock compels dissolution. However, in construing a statute such as North Carolina's, which is "permissive in its terms," the court will consider the circumstances of the case in addition to the requirements contained in the statute. For example, if the facts indicate that dissolution of the corporation will be followed by the establishment of a new business by some shareholders to the exclusion of others, thus resulting in essentially an appropriation of the corporation's goodwill, the court will be reluctant to grant dissolution even though the statutory requirements for dissolution have been satisfied.
In addition, the courts often look to the "public interest" and require that the deadlock be injurious to that interest before granting dissolution. Other factors often articulated are the needs of benefit to the shareholders, and the need for a proper "balance" of the "conveniences of both parties." These additional factors used by the courts to determine whether or not to exercise their discretion to grant dissolution can be viewed as a judicial attempt to balance the equities in a given case and so to grant dissolution only to worthy parties. The problem with such a procedure, however, is that an aggrieved party will often have great difficulty in predicting whether a court will agree with him that his equities outweigh his opponent's. The statute thus gives a less-than-clear indication of what the shareholder's rights under it are.

Aside from these difficulties of interpretation, the statute's gravest shortcoming is that it does not apply to a shareholder deadlock that results from "special provisions or arrangements designed to create veto power among the shareholders." This requirement was put into the act by amendment in 1959 and prohibits the court from dissolving any deadlocked corporation unless the deadlock results from a fifty-fifty voting split of the shareholders; or unless the shareholder deadlock stemming from a high vote requirement results in the deadlock of the board of directors, which is then unable to take any effective corporate action. This fifty-fifty voting split requirement in cases of shareholder deadlock is not characteristic of all states' dissolution-upon-deadlock statutes, but it is contained in a number of them. The rationale behind the requirement seems to be that the charter or by-law provision or

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19 Bradley, A Comparative Evaluation of the Delaware and Maryland Close Corporation Statutes, 1968 DUKE L.J. 525, 547-48. However, the majority view seems to be that good faith is immaterial if the statute authorizes a stated percentage of the corporation's shareholders to petition for dissolution. 2 HORNstein § 789.

20 16A Fletcher § 8036.

21 2 HORNstein § 820.

22 Robinson § 221, at 548.


24 Folk, Revisiting the North Carolina Corporation Law: The Robinson Treatise Reviewed and the Statute Reconsidered, 43 N.C.L. Rev. 768, 866 (1965) [hereinafter cited as Folk].

25 Hinson, Shareholders' Agreements: Negotiations and Drafting, in NORTH CAROLINA BAR ASS'N, supra note 1, at VII-1, -17.

26 The New York statute, for example, specifically permits dissolution upon the petition of the holders of more than one-third of the shares of the corporation if there is in effect a charter provision requiring a greater than majority vote for director action or for election of directors. N.Y. Bus. Corp. Law § 1104(b) (McKinney 1963).

27 16A Fletcher § 8016.1; see, e.g., Fla. Stat. Ann. § 608.28 (1956).
shareholder agreement providing for a high vote requirement should take "precedence over breaking impasse and letting the feuding shareholders end their relationship." Why this should be so is difficult to understand.

The fifty-fifty voting split requirement has been justified on the grounds that when the shareholders inserted a high vote requirement in the corporate charter, they could have also inserted a provision giving any shareholder the unilateral right to dissolve the corporation, pursuant to the authority of section 55-125(a)(3). That section provides that the court has the discretion to dissolve a corporation upon petition of a shareholder if all the present shareholders are parties to, or transferees with notice of, a written agreement allowing the petitioning shareholder to dissolve the corporation at will. Thus in creating veto powers the shareholders could also create an escape from the corporation if deadlock results therefrom by the use of a subsection (a)(3) agreement.

Subsection (a)(3), however, does not provide an adequate safeguard against the effects of the fifty-fifty voting split requirement. First, in order for any shareholder to have the unilateral right to dissolve, all the present shareholders must either be original parties to the agreement conferring the right, or transferees with actual notice of it. If there is a shareholder who was neither an original party to the agreement nor a transferee with notice, the unilateral right to dissolve would be destroyed, but the high vote requirement would remain. Secondly, the agreement providing for the unilateral dissolution right must denominate the specific shareholder as having the right; so if after the deadlock occurs, the shareholder seeking dissolution is not so denominated in the agreement, he is deprived of the escape of dissolution because of the

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2Folk 866.
3N.C. GEN. STAT. § 55-125(a)(3) (1965) provides:
(a) The superior court shall have power to liquidate the assets and business of a corporation in an action by a shareholder when it is established that:

... (3) All of the present shareholders are parties to, or are transferees or subscribers of shares with actual notice of a written agreement, whether embodied in the charter or separate therefrom, entitling the complaining shareholder to liquidation or dissolution of the corporation at will or upon the occurrence of some event which has subsequently occurred ... By the wording of (a)(3), the agreement can also provide that the shareholder is given the unilateral right to petition for dissolution only after the fact of deadlock has occurred.
fifty-fifty voting split requirement unless he can persuade another shareholder who was given the dissolution right to exercise it. Thirdly, because the existence of such a unilateral dissolution right would undoubtedly decrease the transferability of shares (as many potential purchasers would not be willing to entrust the future of their investment to the whim of another shareholder) there is a definite discouraging influence on the employment of subsection (a)(3) agreements in the first place.

In the absence of a subsection (a)(3) agreement, the fifty-fifty voting split requirement can work to deny dissolution relief to a majority shareholder, for example, who could have been granted dissolution had he been merely a fifty-percent shareholder without there being a high vote requirement. The requirement is difficult to justify as a measure to discourage agreements providing for greater than majority voting because the "veto" exception applies whether or not the shareholder himself had agreed to the arrangement; the shareholder who takes his interest with the arrangement already in force is no less bound by it than was his transferor. Section 55-125 should be revised to eliminate this requirement, especially in light of the broad authorization given by the North Carolina Corporations Act for greater-than-majority quorum and voting requirements and the greater possibilities of deadlock they create.

The difficulties in applying the dissolution-upon-deadlock statute are aggravated by a deep-seated judicial reluctance to order dissolution in any case. This judicial reticence probably stems from several sources. First, since dissolution irrevocably destroys a business that is at least potentially viable, many courts avoid it as "court-enforced corporate suicide (or judicial murder)."

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31This opinion has been expressed by Dean Latty: It is a serious matter to have "statutory tolerence of unanimity requirements, high vote and quorum requirements and other partner-like co-control features and yet, despite the deadlocks thereby arising, to provide no 'out,' by dissolution or otherwise." Because corporations statutes are generally drawn with the public corporation in mind, this problem has been generally overlooked. Latty, The Close Corporation and the New North Carolina Business Corporation Act, 34 N.C.L. REV. 432, 447-48 (1956).

32The North Carolina statute authorizes greater-than-majority quorum and voting requirements for directors, N.C. GEN. STAT. § 55-28(d) (1965); greater-than-majority quorum for shareholders, id. § 55-65(a) (1965); and greater-than-majority shareholder voting, id. § 55-66 (1965).


34Bradley, supra note 19, at 547.

35Folk 865.
cerned that dissolution may "trigger adverse tax consequences or cause a sale of corporate assets at sacrifice prices." Further, the courts may feel that dissolution because of deadlock is too powerful a weapon for any party in a position to say, "[I]f you don't do it my way, we'll throw out the baby with the bathwater." These shortcomings of the North Carolina dissolution-upon-deadlock statute can best be appreciated if one realizes the impact they may have on a small close corporation, which might easily have an equal division of voting power and be especially susceptible to deadlock. These corporations are often merely "incorporated partnerships," and the successful operation of any such business is necessarily based on a harmonious relationship among its participants. "[G]iven the frailties of human nature, such relationships can easily be soured for a variety of reasons, ranging from petty annoyances to incompatibility to outright knavery." The inability of such a shareholder in such a business to terminate his association with the company when the working relationships sour is a problem peculiar to close corporations. In a public corporation, the stockholder can sell his shares on the open market. In a partnership, when things come to an impasse, the partner can always bring about dissolution. At worst, the partner may be liable for damages if he improperly dissolves—but he can get out of the business. In a close corporation, however, the shareholder must depend on the relief afforded by the dissolution-upon-deadlock statute, which falls far short of providing satisfactory protection. When the consistent judicial reluctance to grant dissolution relief is combined with the inherent difficulties of utilizing the dissolution statute, the great need for providing remedies other than dissolution is plain.

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38Hinson, supra note 25, at VII-18.
4Latty, supra note 31, at 447.
4See Folk 871.
ALTERNATIVES TO DISSOLUTION

Receiver-Custodian. At common law if a corporation were so paralyzed by deadlock that it was impossible to carry on the business to the advantage of the interested parties, a court was held to have the power to appoint a receiver to manage the affairs of the corporation until the deadlock was broken.44 The American courts have generally acknowledged this rule, but they usually require that the deadlock be so serious that insolvency is threatened.45 Among the reasons frequently advanced by the courts for refusing to appoint a temporary receiver are a reluctance to intrude into the management of a corporation and the adverse effect the appointment of a receiver may have on the corporation's credit.46 Also, many courts have hesitated to wrest control of all the affairs of the corporation from the body in which such control has been statutorily vested.

Faced with this judicial reluctance to exercise equity jurisdiction, several states have expressly given the courts discretion to appoint a receiver or a custodian to manage a corporation's business in the event of deadlock. The Delaware custodian provision is probably the most comprehensive.47 Delaware provides that upon the application of any shareholder the court may appoint a custodian (1) if the shareholders have been unable to elect directors or (2) if the business of the corporation is threatened with irreparable harm because the directors are so divided that they cannot manage the affairs of the corporation and the shareholders cannot break the deadlock.48 The custodian is given essentially all the powers the board of directors had.49 Virginia50 and Pennsylvania61 also provide substantially the same relief.

44Fletcher § 7713.
45Note, 45 Iowa L. Rev., supra note 5, at 772-73. It has been generally held that before a receiver may be appointed for a deadlocked corporation there must be, in addition to the deadlock, misconduct by the directors, officers, or shareholders in control; lack of governing officers; cessation of business; continuous losses; or threatened or actual insolvency. In other words, there must be a real danger to the property interests of the shareholders. Comment, Corporations—Receivership and Dissolution as Remedies for Management Deadlock, 47 Mich. L. Rev. 684, 689-90 (1949).
472 O'Neal § 9.31.
49Id. tit. 8, § 226(b) (Supp. 1968). In addition, id. tit. 8, § 352 (Supp. 1968), provides similar relief for close corporations.
There are problems inherent in these receivership statutes. First, while appointment of a receiver does offer a less drastic alternative to dissolution, like the equitable remedy, it involves the complete relocation of corporate control. Therefore, it does not afford the gentler solutions offered by other types of deadlock remedies. Secondly, the receiver himself is placed in a precarious position, since both factions within the corporation may be anxious to sue the receiver for mismanagement or for improper motivation if the business suffers reverses under his direction.

The use of a receiver for deadlocked corporations does, however, afford certain advantages. It allows a court to give adequate protection to both the shareholders and creditors of the corporation, and it provides in at least the first instance an opportunity to break the deadlock without the drastic remedy of dissolution by giving the parties "a sufficient cooling off period to allow the restoration of an amiable relationship." However, if the causes of the deadlock are sufficiently bitter, the shareholders will simply continue their disagreements once the receiver is removed. In such circumstances, the appointment of a receiver would have accomplished little more than that which would have been possible if other, less drastic remedies—for example, the appointment of a provisional director—had been available. As with dissolution, the severe nature of receivership in relation to what it can accomplish for a deadlocked corporation perhaps explains the courts' reluctance to exercise their discretion to use it. Therefore, in light of the advantages and disadvantages of the receivership statutes, they are probably not an adequate alternative to the dissolution-upon-deadlock statute.

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33 Fales, supra note 37, at 463.
34 2 O'Neal § 9.31, note 9.
35 Id. § 9.31.
37 Id.
38 See text accompanying notes 89-105 infra.
39 In Paulman v. Kritzer Radiant Coils, Inc., 37 Del. Ch. 348, 143 A.2d 272 (Ch. 1958), construing the precursor to the present Delaware receivership statute, DEL. CODE ANN. tit. 8, § 226 (Supp. 1968), the court was presented with a typical deadlock situation: two twenty-five percent shareholders could not agree with the fifty percent shareholder, and as a result the shareholders had failed for four annual meetings to elect directors. Nevertheless, the court, stating that the statute did not require it to appoint a receiver, refused to do so, saying that the possibility of deadlock was "necessarily implicit in the arithmetic of stock holdings." 37 Del. Ch. at 351, 143 A.2d at 274.
Arbitration. Another possible remedy that could serve as an alternative to dissolution for a deadlocked corporation is mandatory arbitration. This type of relief has not been enacted by any state as yet, but it would seem to offer for many deadlocked corporations advantages far superior to either dissolution or receivership.

One possible statutory scheme would make arbitration available in the eventuality of deadlock unless the parties have expressly agreed not to permit it. A stated percentage of the shareholders on either side of the disagreement could petition for an order compelling the other side to arbitrate, and the parties would be bound by the arbitrator's decision unless both sides agreed not to abide by it.60

The advantages of such a provision are several. First, the triangular dialogue between the parties may increase the chances of compromise by creating an atmosphere conducive to settlement. The arbitration proceedings would afford privacy, which would appeal to shareholders who do not want internal squabbles brought out in open court. Arbitration is also faster and less expensive than litigation, and "[s]peed is particularly desirable where personal animosities threaten irreparable harm to the business."61 Most importantly, arbitration would allow using as the arbitrator an expert in the particular matters over which the parties are deadlocked, thereby maximizing the chances of arriving at the best possible business decision and increasing the likelihood of subsequent cooperation among the estranged shareholders. And since the arbitrator would be deciding what action the corporation should take only in relation to the specific disagreement causing the deadlock, arbitration, unlike receivership, does not involve the complete confiscation of corporate control.

Since no state has enacted a mandatory arbitration statute, it is difficult to predict how such a provision would be received by the courts. It is possible that many courts would use other powers to circumvent the effect of the statute in light of the traditional judicial opposition to arbitration.62 However, arbitration as a deadlock-breaking device appears to be generally attractive to the North Carolina corporate bar. A survey conducted in 1969 by Professor Donald Clifford under a grant from the North Carolina Law Center indicated that a majority of the

61Id. at 285.
62See text accompanying notes 108-09 infra.
state's corporate lawyers favored the adoption of a provision making shareholder agreements to arbitrate enforceable and that if such a statute were in effect, over seventy percent of the lawyers responding would use it.63

Nevertheless, while a mandatory arbitration statute would have the virtue of affording relief tending to heal rather than to destroy the corporate entity,64 it would divest the corporate participants of control over the resolution of the immediate question given to the arbitrator. In that respect, arbitration is relief in the nature of, but less drastic than, receivership. And like receivership, arbitration accomplishes nothing that could not be also accomplished by the less severe remedy of the appointment of a provisional director.65

"Section 210 Relief." The most sweeping alternative to dissolution is so-called "section 210 relief," patterned after section 210 of the English Companies Act.66 That section provides that if a court is presented with a petition that would justify dissolution of a corporation, the court may, instead of dissolving, "make such order as it thinks fit" to bring to an end the matters complained of.

South Carolina is the only state to have enacted a statute similar to section 210.67 Under the South Carolina provision, if a shareholder files a petition for dissolution under the state's dissolution statute,68 the

63North Carolina Law Center, Survey of North Carolina Corporate Bar, summer 1969 (unpublished data in office of Professor Donald Clifford, Chapel Hill, N.C.). The questions asked were: "The 1969 legislature considered but did not pass an arbitration act which would have made enforceable agreements to arbitrate future disputes. (a) If such an act were in force in North Carolina, would you be likely to recommend use of arbitration agreements as a means of resolving shareholder conflicts or deadlocks?" Of those responding, 73.4% said yes, and 25.5% said no. "(b) Please indicate whether or not you would favor the adoption of such an arbitration act." Of those responding, 21.7% strongly favored it, 49.7% favored it with reservations, 7.9% were neutral or had no opinion, 8.5% disfavored it with reservations, and 12.2% strongly disfavored it. On the question of the present enforceability of shareholder agreements to arbitrate future disputes, see text accompanying notes 108-09 infra.

64For a discussion of the psychological effects of arbitration as used for a deadlock breaking device see Note, Some Experimental Parallels to the Deadlocked Close Corporation, 13 U. FLA. L. REV. 232 (1960).

65See text accompanying notes 89-105 infra.

66Companies Act, 11 & 12 Geo. 6, c. 38, § 210 (1948).


68S.C. CODE ANN. § 12-22.15 (Supp. 1971). Among the grounds justifying dissolution are that the directors are so divided that effective action is impossible and the shareholders are unable to end the division, id. § 12-22.15(a)(1) (Supp. 1971), that the shareholders are so divided that directors cannot be elected, id. § 12-22.15(a)(2) (Supp. 1971), and that the shareholders are so divided that the business cannot be conducted to the general advantage of the shareholders, id. § 12-22.15(a)(3) (Supp. 1971).
court may resort to the remedies stipulated in the section 210 statute instead of ordering dissolution. The court's power to issue such relief is discretionary, and it may be exercised as an alternative to dissolution even if the statutory requirements for dissolution are met, whether or not the circumstances are such that dissolution would not be "appropriate." The powers the court may thus exercise include altering or cancelling any provision of the corporation's charter, by-laws, or resolutions; compelling a buy-out of share interests; or "directing or prohibiting any act of the corporation or of shareholders, directors, officers or other persons party to the action."

The South Carolina statute thus affords the fullest array of remedies that can be fashioned to meet the individual circumstances of any deadlock situation. More than any other alternative deadlock remedy, it replaces the present statute's dissolve-or-nothing alternatives with a true choice. In addition, the experience that British companies have had with the section tends to suggest that the mere presence of the relief serves as a strong inducement to shareholders and directors to work out their disagreements among themselves and so to avoid deadlock in the first place.

Nevertheless, there are serious deficiencies in a statute modeled on section 210 because it furnishes virtually no guidelines as to the specific measures a court should take to break deadlock. The corporate participants, as well as any other interested parties, are thrown completely upon the mercy and judgment of the court. The traditional reluctance of courts to deal with questions of business judgment and the fact that most judges are not professionally equipped to do so could well lead the courts either to ignore the statute and order dissolution on the one hand, or to issue ill-founded directives on the other. Additionally, many shareholders undoubtedly regard a court "as a less than ideal forum for resolving their internal squabbles," and therefore may not seek relief under section 210 statute except in the most extreme circumstances in

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9Id. § 12-22.23(b) (Supp. 1971).
10Id. § 12-22.23(a)(1) (Supp. 1971).
11Id. § 12.22.23(a)(2) (Supp. 1971).
12Id. § 12-22.23(a)(4) (Supp. 1971).
13Id. § 12-22.23(a)(3) (Supp. 1971).
15Note, 56 Va. L. Rev., supra note 60, at 278.
order to avoid having to tell all in open court to a possibly unsympathetic judge.  

Even so, the Business Corporation Act Drafting Committee of the General Statutes Commission recommended that the 1971 North Carolina General Assembly enact a section 210 statute identical to that of South Carolina, and the same recommendation will be made again in 1973. Despite the fact that survey results indicate that adoption of such a measure is generally favored by the North Carolina corporate bar, there are deficiencies inherent in this type of deadlock relief such that the Committee's recommendations in this regard should be pretermitted in favor of other, more clearly specified remedies.

Compulsory Buy-out of Shares. Another alternative to dissolution upon deadlock is a compulsory buy-out of shares. This remedy can be fashioned to function in two different ways. First, it could provide

79Id. The note writer suggested that the fact that the South Carolina statute has failed to produce a single reported case may demonstrate that shareholders are reluctant to petition for relief under the provisions. Id. One of the ways in which section 210 deadlock relief differs from the other alternatives is that it is the only remedy which requires the judge to learn all of the business aspects of the corporation concerned in order to formulate the decree he will issue to break the deadlock.

77H. 366, § 34, 1973 N.C. General Assembly, reprinted, Clifford (Appendix). The proposal is to add a new section 55-125.1 to the General Statutes to read: Discretion of court to grant relief other than dissolution.

(a) In any action filed by a shareholder to dissolve the corporation under G.S. 55-125(a), the court may make such order or grant such relief, other than dissolution, as in its discretion it deems appropriate, including, without limitation, an order

(1) canceling or altering any provision contained in the charter or by the bylaws of the corporation; or

(2) canceling, altering, or enjoining any resolution or other act of the corporation; or

(3) directing or prohibiting any act of the corporation or of shareholders, directors, officers or other persons party to the action; or

(4) providing for the purchase of their fair value of shares of any shareholder, either by the corporation or by other shareholders.

(b) Such relief may be granted as an alternative to a decree of dissolution, or may be granted whenever the circumstances of the case are such that relief, but not dissolution, would be appropriate.

78Clifford 1-27. The respondents were asked if they favored or disfavored adding discretionary relief to the North Carolina Business Corporations Act. The question read: "Under this kind of provision the court may give a broad range of relief either as an alternative to a decree of dissolution or whenever the circumstances of the case are such that relief, but not dissolution, would be appropriate. Such relief may include, at the discretion of the court, a forced share purchase, a change in the bylaws or articles of incorporation, or some other relief tailored to the facts of the case." Of those responding, 18.9% strongly favored it, 44.3% favored it with reservations, 18.4% were neutral or had no opinion, 14.1% disfavored it with reservations, and 4.3% strongly disfavored it.
that once a shareholder has sued for dissolution because of a deadlock, any other shareholder may petition the court to appraise the value of the petitioner's shares. After the appraisal the other shareholder may elect to buy the petitioner's shares at the appraised value.\footnote{9}

The second way in which the remedy could function is as follows: when a petition for dissolution has been filed by a shareholder, but the court finds in its discretion that relief, but not dissolution, is called for, the court could compel the purchase at fair value of the shares of any shareholder, either by the corporation or by other shareholders. This is the form of buy-out remedy contained in the South Carolina section 210 statute\footnote{8} and is the form that will be recommended for adoption by the 1973 North Carolina General Assembly.\footnote{91}

There is a distinct difference between the two forms of the remedy. In the first, the party to the deadlock desirous of continuing the business is merely given the option by the statute of purchasing the other party's interest in the corporation. If he does not exercise this option, his position in relation to the dissolution petition is no worse than it was before the option was given. The party being bought out is not prejudiced because he has sued for a liquidation of the corporation, and the appraised value of his shares will presumably be no less than their value in dissolution. The central purpose of such a provision is to prevent a dissident shareholder from using the threat of dissolution to "bludgeon the defendant into a buy-out at an inflated price."\footnote{82}

The buy-out remedy as implemented by South Carolina's section 210 statute empowers the court to order either the corporation or any shareholder to buy out the shares of any other shareholder. As with the first form of buy-out remedy, forcing a shareholder who sues for dissolution to sell his interest cannot prejudice him because he gets essentially what he sued for. However, the party compelled to buy the shares may very well be in no economic position to do so, whether he is the plaintiff in the dissolution proceedings, a defendant shareholder, or the corporation itself. Much financial hardship can be avoided by permitting the court to fix an installment payment schedule in addition to the price to be paid.\footnote{83} Nevertheless, under this form of buy-out a possibility of

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extortion could remain if a shareholder, especially a minority shareholder, intentionally creates a deadlock situation in the hope that a court will direct a sale of his shares to other corporate factions. By the same token, a majority shareholder is in an especially good position to arrange for deadlock as a means of forcing another shareholder out of the corporation. The availability of a judicial buy-out order could invite abuse of majority status in a case in which the majority foresees a very profitable future for the corporation and a likelihood that the appraised value of the corporation's shares will be less than the discounted value of their potential future earning capacity.

It is true, however, that under the section 210 form of buy-out remedy, as under the first form, the court does have discretion in deciding whether or not to issue a buy-out order; and the potential for extortion due to the compulsory nature of the section 210 version is not as great as it would be in the absence of this discretion. Because the court would have the option of turning to the other forms of relief that are authorized by the section 210 statute, as a practical matter it would seem unlikely that a shareholder could be able to use the court as a lever to force an unwanted purchase or sale of shares on the other side if hardship would result.

Both forms of court-ordered buy-out possess the singular virtue of breaking the corporate deadlock once and for all while preserving the enterprise as a going business and offering reasonable assurances that a dissatisfied shareholder will realize a fair price for his holdings. Both forms could also serve as a strong inducement to corporate participants to avoid deadlock situations so as not to be forced to purchase a large stock interest in order to preserve the business. And of course, the availability of an alternative to dissolution should discourage the courts' tendency to do nothing when they are faced with the choice of ordering dissolution or doing nothing. In view of these advantages, it is to be hoped that the 1973 General Assembly will adopt some form of buy-out provision. The first form, giving the court the power to grant an option to purchase, involves little danger of abuse. The second form, if coupled with the safeguards of empowering the court to set the prices for the shares, to fix an installment payment schedule, and to consider

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5See text accompanying notes 34-37 supra.
6Bradley, supra note 19, at 546.
a shareholder's good faith, could go even further in providing a much-needed and far-reaching alternative to dissolution upon deadlock.

The Provisional Director. Another alternative to dissolution in the case of deadlock is the appointment of a provisional director. California's statute is the prototype of this form of relief. If a corporation has "an even number of directors who are equally divided and cannot agree as to the management of its affairs, so that its business cannot longer be conducted to advantage or so that there is danger that its property and business will be impaired and lost," one-half of the directors or one-third of the shareholders may petition for an impartial person to serve as a director until he is removed by the court or ousted by a majority of the shareholders. The provisional director is vested with all the powers of any other director, including the rights of notice and voting.

Using a provisional director as a deadlock-breaking device offers many advantages not afforded by other remedies. First, unlike dissolution or compulsory buy-out, it does not require permanent alteration of the corporation's structure of ownership. When the cause of the deadlock is removed, the director is removed, either by court order or vote of the corporate participants, and the former composition of the board is restored. Secondly, unlike receivership, the provisional director remedy does not require that control over corporate action be entirely wrested from the participants. Under receivership the custodian or receiver is solely responsible for making all decisions that the directors were formerly collectively responsible for making. The provisional director remedy, on the other hand, involves simply adding one more person to the decision-making group. It is true, of course, that the provisional director is intended to hold the balance of power with regard to those questions causing the deadlock. But the advantage of the remedy is that with respect to other questions, where the original directors...
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are in agreement, the authority to make decisions will remain in them.

Additionally, the provisional director remedy contemplates a disinterested outsider\(^4\) who will act in the best interests of the corporation until he is removed.\(^5\) It thereby affords an opportunity to bring into the decision-making process a participant who may have some expertise in the area of conflict causing the deadlock. Thus, unlike the arbitrator, who is limited to addressing himself only to the issue presented to him, the provisional director may be able to command a certain trust and respect from the other directors in promulgating new ideas or alternatives to improve the general health of the enterprise.\(^6\) The provisional director differs from an arbitrator in one other important respect: because he can operate in a setting and atmosphere familiar to the other directors the provisional director is in a unique position to effect a comprehensive settlement among the factions.\(^7\)

The leading case\(^8\) interpreting the California provisional director statute, *In re Jamison Steel Corp.*,\(^9\) illustrates the flexibility afforded by this remedy. There the allegation was that the board of directors was so evenly divided that disagreement was paralyzing the corporation's ability to make a profit. The corporation's four-man board of directors was evenly divided on questions of declaring dividends, having the company's books independently audited, and increasing the number of directors. In addition, the board had been unable to elect new officers. The court said that the provisional director remedy was designed to be used before the stage at which the need for the more drastic remedies of receivership or dissolution is reached, and therefore the mere perpetuation of existing policies or incumbent officers is a failure of corporate management sufficient to support the appointment of a provisional director.\(^10\)

There are, however, certain problems inherent in the provisional director remedy.\(^11\) First, if the root cause of the deadlock is the basic

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\(^{4\text{Cal. Corp. Code } \\ 819(b) (West 1955). All of the provisional director statutes specify criteria for ensuring that the person appointed is bona fide impartial. See, e.g., Ga. Code Ann. \\ 22-703(c) (1970).}\)


\(^{6\text{Id.}}\)

\(^{7\text{Folk 867.}}\)

\(^{8\text{2 O'Neal } \\ 9.30.}}\)

\(^{9\text{158 Cal. App. 2d 27, 322 P.2d 246 (1958).}}\)

\(^{10\text{Id. at ——, 322 P.2d at 251.}}\)

\(^{11\text{There is also a problem of interpretation involved in a provisional director statute such as California's. That is whether the statute gives the provisional director all the powers conferred on}}\)
incompatibility of the principals, the appointment of a provisional director "may only postpone the day when more drastic remedies must be invoked." However, since the appointment of a provisional director is intended to be a gentle form of relief and since it may lead to a reconciliation of the principals, its use should not be discounted merely because it will not always be the final remedy that must be employed by the court in a given situation. Moreover, any form of relief that does not alter the corporation's structure may be only postponing more drastic measures.

The Business Corporations Act Drafting Committee of the General Statutes Commission will submit a provisional director statute for adoption by the 1973 North Carolina General Assembly. It is pat-

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1 Folk, supra note 95, at 953.

(a) If the directors of a corporation are deadlocked in the management of the corporate affairs and the shareholders are unable to break the deadlock, and if injury to the corporation is being suffered or is threatened by reason thereof, the superior court of the county where the registered office of the corporation is located may, notwithstanding any provisions of the charter or bylaws of the corporation and whether or not an action is pending for an involuntary dissolution of the corporation, appoint a provisional director pursuant to this section.

(b) Action for such appointment may be filed by not less than one-half of the directors or by the holders of not less than one-third of the total outstanding shares of the corporation regardless of voting rights. Notice of such action shall be served upon the directors (other than those who have filed the action) and upon the corporation in the manner provided by law for service of a summons and complaint, and a hearing shall be held not less than ten days after such service is effected. At such hearing all interested persons shall be given an opportunity to be heard.

(c) The provisional director shall be an impartial person, who is neither a shareholder nor a creditor of the corporation, nor related by blood or marriage to any of the other directors of the corporation, or to any judge of the court by which he is appointed. The provisional director shall have all the rights and powers of a director, and shall be entitled to notice of the meetings of the board of directors and to vote at such meetings, until he is removed by order of the court or by vote or written consent of the holders of a majority of the voting shares or holders of such higher number of voting shares as may be required under the charter or the bylaws for the election of directors. He shall be entitled to receive such compensation as may be agreed upon between him and the corporation, and in the absence of such agreement he shall be entitled to such compensation as shall be fixed by the court.
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terned after the Georgia provisional director statute, and follows that statute in eliminating the need for an arithmetically divided board of directors before the remedy can be utilized. Because the remedy offers many unique advantages and poses few serious dangers, the General Assembly should adopt it.

CONCLUSION

The shareholder in a close corporation that is suffering from a deadlock is peculiarly at the mercy of the state corporation statute's deadlock provisions. If he is fortunate, there may be private provisions drawn in the past that will resolve a deadlock situation. For example, a shareholder agreement or a charter provision might provide that impartial outsiders would be brought in to manage the business in the event of deadlock, or that a voting trust might be used for temporary management. However, the attractiveness of contractual arrangements as an alternative to the statutory remedy is minimized for at least two reasons. First, these devices are available "only where the incorporators had sufficient acumen and foresight to recognize the possibility of eventual conflict." Secondly, there is a "substantial question as to the enforceability of an arbitration agreement in North Carolina." At common law, arbitration agreements dealing with future corporate disputes were not enforceable, partly because of the attitude of the courts that shareholder compacts may not subvert the policies of majority rule and busi-

Survey results indicate that the North Carolina corporate bar generally favored adoption of a provisional director remedy. The question asked was: "Under this type of remedy, if an evenly divided board of directors is deadlocked, half of the directors or a third of the shareholders may seek a court order designating an 'impartial person' to serve as director so long as the court keeps him in office or until he is removed by a majority of the shareholders. The provisional director is given the power of an ordinary director, including the right to notice, to attend meetings, and to vote. This remedy has been characterized as 'essentially a method to force arbitration on warring factions.' " Of those responding, 9.6% strongly favored it, 39.6% favored it with reservations, 21.4% were neutral or had no opinion, 19.3% disfavored it with reservations, and 10.2% strongly disfavored it. Clifford I-27.


See text accompanying notes 23-33 supra on the need to eliminate the requirement for a fifty-fifty voting split for deadlock relief to be applied.

Also, the shareholder-incorporators could have entered a section 55-125(a)(3) agreement by which a specified shareholder was given the power to petition for dissolution at will, or by which the occurrence of deadlock conferred such power on the shareholder. See text accompanying notes 29-31 supra.

Note, 56 VA. L. REV., supra note 60, at 272.

Hinson, supra note 25, at VII-16.