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Corporations—Dissolution at Instance of Minority Stockholders

At one time minority stockholders were unable under any circumstances to sue for and obtain a dissolution of winding up\(^1\) of a corporation and a distribution of its assets. It was uniformly\(^2\) held that courts of equity, by virtue of their lack of inherent power, \(i.e.,\) lack of power absent statutory delegation,\(^8\) were incapable of affording such drastic relief\(^4\) in a suit from that quarter.\(^5\)

Prior to the widespread enactment of general incorporation laws, one of the reasons for the rule was that the corporate charter was a special dispensation of the State—from which it was inferred that only the State could revoke it. But the deep entrenchment of the rule and the uniformity of its application were ultimately due in large measure to the then extreme rarity of corporate abuses that would justify dissolution, in contrast to the abundance of circumstances for which a lesser remedy, or no remedy at all, would be suitable. This extreme disproportion served as a basis upon which the courts confounded the alleged lack of power with the undesirability of exercising it in a great majority of cases.\(^6\) Thus the courts arrived, by way of an overweening generalization, at a rule which was categorical both in statement and application; but which in statement was essentially unsound, and in application occasionally unjust.

That courts of equity do have the power in the absence of statute to dissolve or wind up a corporation and distribute its assets at the instance of minority stockholders is strikingly illustrated by decisions repudiating the old view, handed down in jurisdictions whose previous adherence to that view had been undeviating.\(^7\) These courts which have reversed their positions together with others, which on first impression have adopted the new rule, now constitute a majority.\(^8\) Under this common

\(^1\) The distinction between winding up and dissolution is formal only; in either case the corporate existence is effectively terminated. See Verplanck v. Mercantile Ins. Co., 2 Paige 438, 452 (N. Y. 1831).
\(^2\) The first case to hold to the contrary was decided in 1892. Miner v. Belle Isle Ice Co., 93 Mich. 97, 53 N. W. 218 (1892).
\(^3\) The first statute of this kind was enacted in 1848. 11 & 12 Vict., c. 45, §5 (1848). The earliest enactment in this country was prior to 1868. W. Va. Code c. 53, §57 (1868).
\(^4\) The appointment of a temporary receiver is a common example of a less drastic measure of relief.
\(^5\) See Note, 43 A. L. R. 242, 288 (1926).
\(^6\) E.g., compare the following cases with cases from the same jurisdictions cited in note 5 supra: Potter v. Victor Page Motors Corp., 300 Fed. 885 (D. Conn. 1924); Metropolitan Fire Ins. Co. v. Middendorf, 171 Ky. 771, 188 S. W. 790 (1916); Brent v. B. E. Bristed Sawmill Co., 103 Miss. 876, 60 So. 1018 (1913); Goodwin v. von Cotzhausen, 171 Wis. 351, 177 N. W. 618 (1920).
\(^7\) Hornstein, A Remedy for Corporate Abuse, 40 Col. L. Rev. 220 (1940).
law view it has been held that the court has power to wind up a corporation in a variety of appropriate circumstances, including, separately or mingled, gross mismanagement,9 deadlock,10 fraud,11 abandonment of the corporate functions,12 and failure of the corporation's principal object or purpose.13 Most of the jurisdictions which assert a lack of power "in the absence of statute," along with those recognizing an inherent power, have enacted statutes specifying grounds—the aforementioned14 and/or others15—upon which suit may be brought.

The power must be exercised cautiously,16 and its exercise is prohibited where a lesser remedy would be adequate.17 Accordingly, the cases are legion where the courts, while acknowledging the power to dissolve in an appropriate case, refuse to exercise it because such a case has not been made out.18

In a recent Virginia case19 minority stockholders of a corporation, organized for the principal purpose of conducting a leaf tobacco business, brought suit for dissolution alleging that the principal purpose had

9 E.g., Klugh v. Coronaca Milling Co., 66 S. C. 100, 44 S. E. 566 (1903).
10 E.g., In re Dissolution of the Waldorf Amusement Co., 13 Ohio App. 438 (1920).
12 E.g., Central Land Co. v. Sullivan, 152 Ala. 360, 44 So. 644 (1907).
14 CAL. CORP. CODE §4651 (1947) (abandonment, deadlock, fraud); CONN. GEN. STAT. §5226 (1949) (fraud, gross mismanagement, abandonment), ILL. ANN. STAT. c. 32, §157.86 (1935) (deadlock, fraud); LA. GEN. STAT. ANN. §1135 (1939) (failure of objects, abandonment, deadlock); ME. REV. STAT. c. 49 §100 (1944) (fraud, gross mismanagement); MINN. STAT. §301.49 (Henderson 1945) (failure of objects, abandonment, fraud, deadlock, mismanagement); MO. REV. STAT. ANN. §4977.82 (1933) (fraud, deadlock); NEV. COMP. LAWS ANN. §1648.01 (Supp. 1942) (fraud, gross mismanagement, abandonment); OHIO GEN. CODE ANN. §8623-86 (1938) (deadlock, abandonment, failure of objects); OKLA. STAT. ANN. tit. 18, §1.195 (Supp. 1948) (failure of objects, abandonment, deadlock); PA. STAT. ANN. tit. 15, §2852-1107 (1938) (failure of objects, abandonment, fraud, deadlock); R. I. GEN. LAWS c. 116, §57 (1938), as amended, R. I. Acts 1945 c. 1610 (fraud); VA. CODE ANN. §3810b (Supp. 1948) (failure of principal purpose); WASH. REV. STAT. ANN. §3803-50 (Supp. 1932) (failure of objects, abandonment, deadlock).
15 CAL. CORP. CODE §4651 (1947) (liquidation reasonably necessary to protect stockholder's interests); CONN. GEN. STAT. §5226 (1949) (any good and sufficient reason); ILL. STAT. ANN. c. 32, §157.86 (1935) (misapplication and waste of assets); IOWA CODE §491.66 (1946) (good cause); ME. REV. STAT. c. 49, §100 (1944) (imminent danger of insolvency); NEV. COMP. LAWS §1648.01 (collusion, misfeasance, malfeasance, nonfeasance); N. D. REV. CODE §10-1607 (1943) (one year suspension of ordinary business); OKLA. STAT. ANN. tit. 18, §1.195 (Supp. 1948) (beneficial to interests of stockholders); S. C. CODE ANN. §7725 (1942) (nonpayment of dividends or inability to pay dividends in good faith over stated intervals); W. VA. CODE ANN. §3093 (1) (1943) (sufficient cause).
16 See discussion in Goodwin v. von Cotzhausen, 171 Wis. 351, 361, 177 N. W. 618, 622 (1920).
17 Thwing v. Minowa Co., 134 Minn. 148, 158, N. W. 820 (1916).
failed. It was shown that the majority stockholders in control had suspended the tobacco business during the war period—when that business was highly speculative—and during the postwar period of inflation, and had invested the corporation's idle capital, profitably, in stocks and bonds. The court held that although by the general rule, of which the statute\textsuperscript{20} in part is declaratory,\textsuperscript{21} a court of equity has inherent power to dissolve a solvent corporation because of fraud or gross mismanagement or failure of the corporate purpose, dissolution was not warranted by the facts presented. The case is significant inasmuch as it expressly recognizes that a court of equity has the power to dissolve independently of statute, and that the exercise of the power depends upon the application of general principles of equity to the merits of the case.

North Carolina has provided by statute\textsuperscript{22} certain general and specific grounds upon which dissolution may be granted in suits instituted therefor by minority stockholders. These include (1) abuse of the corporate powers to the injury of stockholders, (2) nonuse of the corporate powers for two or more consecutive years, (3) suspension of ordinary business for want of funds, or imminent danger of insolvency, and (4) nonpayment of dividends for certain intervals. But certain of the grounds enumerated above, \textit{viz.}, fraud, gross mismanagement, deadlock, and abandonment\textsuperscript{23} for less than a two year period, for which the remedy is commonly available in appropriate cases in most jurisdictions, are either excluded completely or subject to inclusion only by future construction of the statute. Fraud very probably is an abuse of the corporate powers within the meaning of the statute;\textsuperscript{24} but it would be more difficult to find that the same is true of gross mismanagement where fraud is lacking. Both deadlock and abandonment for less than two years are distinctly without the purview of the statute, and failure of the corporate purposes is at best only partially embraced.

The question whether in North Carolina equity has "power" to dissolve or, more accurately, will recognize its power to dissolve, in the absence of statutorily specified circumstances, is therefore one of practical moment.

Although there are no holdings on the question,\textsuperscript{25} there is one statement by a dissenting judge, uttered at a time when the weight of au-

\textsuperscript{20} VA. CODE ANN. §3810b (Supp. 1948).
\textsuperscript{22} N. C. GEN. STAT. §§55-124, 55-125 (1943).
\textsuperscript{23} Abandonment is the critical fact; nonuser, except under statutory provision, is merely evidence of it. Sullivan v. Central Land Co., 173 Ala. 426, 55 So. 612 (1911).
\textsuperscript{24} In one case, however, where fraud was clearly present, but where imminency of insolvency was not so clearly present, the court, in appointing a receiver, rested its decision on the latter basis, neglecting to construe the "abuse of power" provision. Mitchell v. Aulander Realty Co., 169 N. C. 516, 86 S. E. 358 (1915).
\textsuperscript{25} Contra: Note, 34 VA. LAW REV. 56, 57 (1948).
authority was in the process of shifting, to the effect that "... it is well settled ... that in the absence of statutory provision to the contrary, only the State which created the corporation can sue to dissolve it." Cited in support of the contention that the rule is well settled are one treatise and four North Carolina cases. The writer of the treatise asserts that equity has, as a general rule, no power or jurisdiction to dissolve, in the absence of statute, upon the suit of minority stockholders, but lists, with evident approbation, several exceptional circumstances (including most of the aforementioned appropriate grounds) in which equity may properly exercise that power. Thus the writer, by admitting the "exceptions," admits the existence of the power, but in his statement of the "general" rule, with regard to the reason why dissolution should not be granted in inappropriate cases, seems to be involved in the persistent verbal confusion between the existence of the power and the desirability of exercising it.

The dissenting statement finds even less support in the cases cited. In two of these, suits were brought by minority stockholders for dissolution on statutory grounds, but no statement appears which negates, either expressly or by implication, equity's power in the absence of statute. The other two cases, although they contain statements ostensibly applicable upon inspection, in fact involve suits brought by parties other than those interested in the corporation for a remedy unrelated to dissolution, and are as distinctly irrelevant in law as in fact to the "well settled" rule which they were cited to support.

Compare Note, 19 IOWA LAW REV. 95 (1933), with Hornstein, A Remedy for Corporate Abuse, 40 COL. LAW REV. 220 (1940). For observations that the rule had previously changed, see Hall v. City Park Brewing Co., 294 Pa. 127, 132-133, 143 Atl. 582, 583-584 (1928); Goodwin v. von Cotzhausen, 171 Wis. 351, 358-361, 177 N. W. 618, 621-622 (1920); BALLITLNE, PRIVATE CORPORATIONS §253 (1927).


Indeed, a statement in the earlier of these two cases may be, and has been, interpreted as a recognition of equity's power in the absence of statute. See 19 C. J. S. Corporations §1716 (1940). Torrence v. Charlotte, 163 N. C. 562, 80 S. E. 53 (1913); Bass v. Navigation Co., 111 N. C. 439, 16 S. E. 402 (1892).

The later case merely quotes the pertinent statements of the earlier one. The facts of both cases were essentially the same. The grantors of land (under eminent domain proceedings) to the defendant corporations sued to recover the land, alleging that the existence of the corporations had been terminated, and thus their charters forfeited, by virtue of changes in the originally chartered purposes for which the land had been taken. Thus, when the court says in Bass v. Navigation Co., supra, note 12, at p. 449, "It rests with the sovereign to insist upon the forfeiture
Another case,\(^5\) wherein dissolution was granted under circumstances encompassed by statutory provision,\(^6\) but wherein proceedings had not been brought pursuant to the statute, might plausibly stand for the proposition that dissolution may be granted independently of statute, and hence for the principle that equity has power in the absence of statute. That the action, although brought in equity, was brought on a statutory ground, and was for that reason\(^7\) entertained or condoned by the court, might suggest a contrary inference.

The justice and equity of dissolution in proper cases may be founded on principles of trust and contract. The tenet of majority rule in corporate management is qualified by an implicit trust relationship between the directors, or the majority stockholders, and the individual stockholder. Accordingly, it is the duty of those in control to manage the corporate affairs honestly for the benefit of all concerned—not merely for the benefit of the majority or controlling interests.\(^8\) Consequently, if the corporate objects fail, if the corporate functions are abandoned, or if the corporation is doomed to eventual insolvency, that duty is breached by a failure to wind up the corporation. Otherwise, the stockholder’s investment would probably be subject, not merely to futile stagnation, but to the various intrigues of the controlling interests, and to progressive dissipation in taxes and salaries.

The pertinent principle of contract is that by which one party has the right to “rescind (e.g., withdraw from the corporation) after the other has persistently failed to comply with his part of the contract (e.g., refused to act in the collective interest of the group).”\(^9\)

The contention that the power can be abused is perhaps the most persistent objection to it. But difficult as it is to foresee general consequences in matters of this kind, it would be still more difficult to see how judicial abuses of the power, as cautiously as it has been exercised

\(^{5}\) Greenleaf v. Land & Lumber Co., 146 N. C. 505, 60 S. E. 424 (1908).

\(^{6}\) N. C. GEN. STAT. §55-124 (2) (1943) (nonuser of powers for two or more years).

\(^{7}\) We can perceive no good reason, however, for dismissing this action, wherein all parties in interest are now or, under his Honor’s order, will be brought into court and the same relief awarded as if the provisions of the statute had been complied with.” Greenleaf v. Land & Lumber Co., 146 N. C. 505, 507-508, 60 S. E. 424, 425 (1908).


\(^{9}\) Hornstein, A Remedy for Corporate Abuse, 40 Col. L. Rev. 220, 225 (1940).
in the past, could approach the intracorporate abuses rendered perpetrable by non-recognition or denial of the power.

Thus far, the only situations to arise in which the courts have deemed it just and equitable to decree dissolution have arisen within the categories already mentioned. But these categories are mere collections of abuses already presented rather than inflexible limits of the rule; so that the real reason for applying the remedy in a particular case is now, as it was initially, that such action is just, equitable, and socially desirable.

As previously noted, all the presently appropriate circumstances for dissolution are not covered by statute in North Carolina. If they were, then it would, presently, make no practical difference whether the court had "inherent power" or not; in that event the question would, for the time being, be academic. The history of the remedy, however, has shown that the growth of circumstances warranting dissolution is concomitant with the growth and variegation of corporate activity. Assuming that this concomitancy will continue, statutory coverage of the ground, however liberal, must assuredly lag behind the evolving demands of justice and equity. It is hoped, therefore, that when confronted with an appropriate case the court will recognize and exercise its inherent power, refusing to construe the statute as exclusive.

PARKER WHEDON.

Damages—Mental Anguish—Action Arising Out of Contract

Plaintiff contracted with the defendant undertakers to bury plaintiff's deceased husband. Approximately four months after internment,