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THE RIGHT OF MINORITY STOCKHOLDERS TO PREVENT THE DISSOLUTION OF A PROFITABLE ENTERPRISE

ROBERT A. SPRECHER*

Most states have statutes which provide for the dissolution of corporate enterprises upon the affirmative vote of a specified number of stockholders.¹ However, can minority stockholders prevent voluntary dissolution of a profitable, going enterprise by a statutory majority? The answer, it will be seen, varies from state to state. In some states the decision of the majority governs and minority holders are powerless to prevent the dissolution, while in other states the minority holders can veto an attempted dissolution of a profitable enterprise despite compliance by the majority holders with the statutory requisites.

I. RIGHTS OF MINORITY STOCKHOLDERS IN GENERAL

In assessing the limits within which majority stockholders may act without interference and those within which dissenting minority stockholders may effectively prevent action by the majority, it is necessary to determine the dividing line between two fundamental rules of corporate law.

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¹The study which follows embraces fifteen states whose courts have developed the law on the question of the rights of minority stockholders to prevent the dissolution of profitable enterprises. The statutes in those states and the vote required are as follows: ALA. CODE (1940) tit. 10, sec. 105 (two-thirds); CAL. CIV. CODE (1941) div. 1, pt. 4, tit. 1, ch. 15, sec. 400 (majority); DEL. REV. CODE (1935) ch. 65, sec. 2071 (two-thirds); ILL. REV. STATS. (1943) ch. 32, sec. 157.76 (two-thirds); IOWA CODE (1939) sec. 8363 (as provided for in charter); KAN. GEN. STAT. ANN. (Supp. 1939) sec. 17-3602 (two-thirds); KY. R. S. (1942) 271.300 (majority); LA. GEN. STAT. ANN. (Dart, 1939) sec. 1134 (two-thirds); MO. REV. STAT. (1939) sec. 5037 (two-thirds); N. H. REV. LAWS (1942) sec. 96 (majority); N. J. S. A. 14: 13-1 (two-thirds); N. Y. LAWS (Thompson, 1939) sec. 101 (majority of directors); N. C. GEN. STAT. 1943 secs. 55-121 (two-thirds); TEX. STAT. ANN. (Vernon, 1925) art. 1387 (four-fifths); REV. STAT. WASH. ANN. (Remington, 1932) sec. 3834 (two-thirds). Most statutes require a resolution by the board of directors (and sometimes a finding that dissolution is "advisable" or "beneficial") followed by a stockholders' vote.

One of these is that matters of important corporate policy are entrusted to the majority of the stockholders and not to a court at the request of a minority stockholder. This rule has been stated as follows:²

"First, it may be stated, as the result of all the authorities, that whenever any action of either directors or stockholders is relied on in a suit by a minority stockholder for the purpose of invoking the interposition of a court of equity, if the act complained of be neither ultra vires, fraudulent, nor illegal, the court will refuse its intervention because powerless to grant it, and will leave all such matters to be disposed of by the majority of the stockholders in such manner as their interests may dictate, and their action will be binding on all, whether approved of by the minority or not."

The other rule is that a majority stockholder stands in a fiduciary relation to minority stockholders and, hence, the minority stockholder can veto the acts of the majority if such acts constitute a breach of the fiduciary relation.³

Apparently the dividing line between majority-rule and minority-veto has been a wavering one, veering at one time and place in favor of the majority, and at another time and place in favor of the minority.

There has been noted in some recent cases "an increasing unwillingness to interfere with the majority at the behest of the minority, coupled with vigorous expressions as to the obligations owing from the majority to the minority * * *. The rule that a minority stockholder must seek redress within the corporation before applying to the courts has been reiterated * * *. It seems entirely warranted to conclude that the favor shown by reorganization statutes to a majority rule is symptomatic of a general trend in corporation law and is not confined strictly to reorganization problems.⁴

Certain factors, however, are predictable. It is clear that a majority of stockholders can dissolve an insolvent or unprofitable business, whether a statute so provides or not. In *Geddes v.*

² *Shaw v. Davis*, 23 Atl. 619, 621 (Ct. App. Md., 1894).

³ *Singer v. Carlisle*, 26 N. Y. S. (2d) 172, 180 (N. Y. Sup. Ct., Spec. Term, N. Y. County, 1940); *Wheeler v. Abilene National Bank Building Co.*, 159 Fed. 391, 393-4 (C. C. A. 8th, 1908); *Jones v. Missouri-Edison Electric Co.*, 144 Fed. 765, 771 (C. C. A. 8th, 1906).

⁴ *Rohrlich, The New Deal In Corporation Law* (1935) 35 Col. L. Rev. 1167, 1178-9, 1180

Anaconda Copper Mining Company.⁵ the Supreme Court of the United States said:

"When, from any cause, the business of a corporation, not charged with duties to the public, has proved so unprofitable that there is no reasonable prospect of conducting the business in the future without loss, or when the corporation has not, and cannot obtain, the money necessary to pay its debts and to continue the business for which it was organized, even though it may not be insolvent in the commercial sense, the owners of a majority of the capital stock, in their judgment and discretion exercised in good faith, may authorize the sale of all of the property of the company for an adequate consideration, and distribute among the stockholders what remains of the proceeds after the payment of its debts, even over the objection of the owners of the minority of such stock."

It is equally clear that minority stockholders can enjoin any majority action that is fraudulent, illegal, or ultra vires. In *Gamble v. Queens County Water Co.*⁶ the New York Court of Appeals said:

"I think that where the action of the majority is plainly a fraud upon, or in other words, is really oppressive, to the minority shareholders * * * an action may be sustained by one of the minority shareholders * * * to enjoin the action contemplated."

The rule that a majority stockholder stands in a fiduciary relation to minority stockholders becomes operative only in certain situations. Mere ownership of a majority or all the stock of a corporation does not in and of itself spell domination. Stockholders are not *ipso facto* trustees for each other.⁷ It is only when a majority stockholder steps out of his role as a stockholder, and acts in the management and conduct of the corporation, with disregard of the interests of the corporation and of the minority stockholders that he is said to become a fiduciary instead of a mere stockholder.⁸ The cases in which majority stockholders have been said to stand in a fiduciary relation to the minority have been cases in which the court was dealing with a matter of corporate management committed by statute directly to the stockholders rather than to the directors, or cases in

⁵ 254 U. S. 590, 594 (1921).

⁶ 25 N. E. 201, 202 (N. Y. Ct. App., 1890).

⁷ *Blanstein v. Pan American Petroleum & Transport Co.*, 31 N. Y. S. (2d) 934, 956 (N. Y. Sup. Ct., App. Div., 1st Dept., 1941); *Kavanaugh v. Kavanaugh Knitting Co.*, 123 N. E. 148, 151 (N. Y. Ct. App., 1919).

⁸ *Levy v. American Beverage Corporation*, 38 N. Y. S. (2d) 517, 525 (N. Y. Sup. Ct., App. Div., 1st Dept., 1942).

which the majority have in fact assumed the management of the corporation's property or business, or cases in which the majority have undertaken to act for the minority.⁹

Given one of these situations, the next problem is to determine what constitutes a breach of the fiduciary relation. A dominant or controlling stockholder, or group of stockholders, is a fiduciary whose powers are in trust and whose dealings with the corporation are subject to vigorous scrutiny, and where such dealings are challenged, the dominant stockholder must prove the good faith of the transaction and its inherent fairness from the viewpoint of the corporation and those interested therein.¹⁰ A violation of the fiduciary duty of the dominant stockholder to the minority stockholder is not dependent merely on fraud or mismanagement,¹¹ but exists whenever there is bad faith on the part of, or personal advantage to, the dominant stockholder, to the detriment of the corporation and those interested in it.¹²

Some courts, in measuring the fiduciary obligation of dominant stockholders, have applied a more or less subjective test based merely on the "good faith" of the dominant stockholders.¹³ Other courts have applied the more objective test of looking to the relative advantage to the dominant stockholders of a particular transaction as opposed to the disadvantage to the corporation as an entity, and thus holding as immaterial the subjective good faith of the dominant stockholders.¹⁴ The general rule can best be stated as requiring subjective good faith on the part of dominant stockholders but also requiring objective good faith—that is, good faith implied from an examination of the results of the transaction.¹⁵ However, in cases where a statute provides a method for voluntary dissolution and the

⁹ *Gerdes v. Reynolds*, 28 N. Y. S. (2d) 622, 650 (N. Y. Sup. Ct., Spec. Term, N. Y. County, 1941).

¹⁰ *Pepper v. Litton*, 308 U. S. 295, 306 (1939).

¹¹ *Southern Pacific Co. v. Bogert*, 250 U. S. 483, 492 (1918).

¹² *Pepper v. Litton*, *supra* note 10.

¹³ See, for example, *Blanstein v. Pan American Petroleum & Transport Co.*, *supra* note 7; *Crawford v. Mexican Petroleum Co.*, 130 F. (2d) 359 (C. C. A. 2d, 1942).

¹⁴ See *Overfield v. Pennroad Corporation*, 42 F. Supp. 586 (E. D. Pa., 1941) and further opinion in 48 F. Supp. 1008 (E. D. Pa., 1943); Note (1942) 51 YALE L. J. 1034, 1038-9.

¹⁵ *Pepper v. Litton*, *supra* note 10.

statutory method is followed, some courts have held that such action is conclusive regardless of the majority's motive, in the absence of actual fraud, while other courts have held that the minority may enjoin such action if bad faith is shown.

II. RIGHTS OF MINORITY STOCKHOLDERS IN DISSOLUTION CASES GENERALLY

In Fletcher, *Cyclopedia of Corporations*, the following appears:¹⁶

"Where a statute expressly authorizes a majority, or a certain per cent of the stock over one-half, to voluntarily dissolve the corporation, the question arises as to whether this power is absolute as against minority stockholders. That the minority may complain and prevent the dissolution where it is illegal or actually fraudulent as against the rights of the minority is undoubted. But there remain the border line cases, where, while perhaps there is no actual legal fraud, yet the dissolution actually freezes out minority stockholders and is so intended; and in such cases there is much to be said in behalf of the injured minority. The general rule is that where a statute confers power on a majority, or a certain per cent, of the stockholders to dissolve, the right is absolute, so far as the motives of the majority are concerned, in the absence of actual fraud, and not subject to judicial review on behalf of minority stockholders. In other words, where a voluntary dissolution is being effected by the officers or majority stockholders, pursuant to a statute, it is only in rare and exceptional instances that it should be stayed or interfered with by the courts at the instance of minority stockholders, and it is generally no ground for interference that the motive prompting the act is reprehensible or malicious, or that the dissolution seems unwise or improvident, or that the court may not approve of the motive in dissolving. The policy and wisdom of the act is held to be a matter of business judgment rather than a question reviewable by the courts, and the courts will not examine into the affairs of the corporation to determine whether the action was expedient or wise. Thus, a question has arisen as to whether a voluntary dissolution, pursuant to a statute, by a majority of the stockholders, is valid where the purpose of the dissolution was to enable the majority stockholders to acquire the corporate property and continue the business in their own interest. In most of the decisions on this point, it has been held that the minority stockholders cannot complain, although there is an early federal case to the contrary and also some decisions in the state courts upholding a contrary principle."

However, in the same section, the following statements are made:¹⁷

"But even where the dissolving stockholders act in accordance with the letter of the statute, they must do so in good faith. The courts should and will interfere at the instance of minority

¹⁶ 16 FLETCHER, *CYCLOPEDIA OF CORPORATIONS*, § 8022, pp. 735-6.

¹⁷ *Id.* at 737.

stockholders where the dissolution is in bad faith and violates the rights of minority stockholders, or where it has been induced by undue influence or is the result of fraud, or, it would seem, where the dissolution is not intended for the benefit of the corporation or in furtherance of its interests but merely to unjustly oppress the minority, or any of them, and cause a destruction or sacrifice of their pecuniary interests or holdings.

"Statutes authorizing a voluntary dissolution on petition of the managing officers of a corporation should not be construed so as to permit majority stockholders to force out minority stockholders."

And at another place, the following appears:¹⁸

"A minority stockholder may enjoin the majority stockholders from proceeding to dissolve the corporation, where the majority are not acting in good faith."

ALABAMA

In *Waldrop v. Martin*,¹⁹ the majority stockholders voted to dissolve an insolvent national bank pursuant to a United States statute providing for dissolution. The court denied an injunction sought by minority stockholders, saying:²⁰

"Defendants represent the majority stock, and their management of the bank's affairs is not to be controlled by the courts on behalf of minority stockholders in the absence of fraud or gross mismanagement."

The court then held that the fact that a cashier who had embezzled \$95,000.00 was appointed by the liquidating committee to assist it in winding up, did not make the dissolution a fraudulent one.

CALIFORNIA

In *Dommain v. Hydraulic Clutch Co.*,²¹ the directors, acting under a statute permitting dissolution upon the payment of a corporation's debts, levied an assessment upon the stockholders for the purpose of paying the corporate debts, dissolved the corporation, and formed a new corporation in another state to avoid certain California corporate laws. A bill for an injunction by minority stockholders was dismissed on demurrer, the court stating:²²

¹⁸ 13 FLETCHER, CYCLOPEDIA OF CORPORATIONS, § 5836, pp. 176-8.

¹⁹ 188 So. 59 (Ala., 1939).

²⁰ *Id.* at 63.

²¹ 187 Pac. 1069 (Dist. Ct. App. Cal., 1920).

²² *Id.* at 1070.

"The complaint, taking it at its full face value, as we must in this instance, discloses, we think, not one illegal act on the part of the officers or directors of the defendant corporation. A court of equity will not restrain any person from doing that which the law authorizes that person to do. *People v Gold, etc., Mining Co.*, 66 Cal. 155, 4 Pac. 1150. The law which prescribes the method for incorporating as a corporation (section 285 Civ. Code) provides also the method of winding up its affairs as such (section 1227 et seq., Code Civ. Proc.), as well as the actual process of disincorporation. In order to accomplish the latter result, it is a legal prerequisite that the debts of the corporation be paid (section 1228, Code Civ. Proc.), and if necessary, an assessment may be levied for that purpose (section 331, Civ. Code). When the disincorporation has been accomplished, the corporation is dead. Obviously, the 'right, title, and interest' of a dead corporation cannot be transferred anywhere. The fact that the same individuals who at present comprise the officers and directors of the defendant corporation may hereafter go to another state, under the laws of which they may believe more freedom of action will be given to them, while one may not approve of that course, still it is a violation of no law, and is but the exercise of a right guaranteed under the Constitution of the United States."

DELAWARE

In *Allied Chemical & Dye Corporation v. Steel & Tube Co. of America*,²³ Allied Chemical & Dye Corporation was a minority stockholder in Steel & Tube Co. of America. When Steel & Tube Co. attempted to sell all of its assets to Youngstown Sheet & Tube Company, Allied Chemical brought suit for an injunction, alleging fraud. The court discussed the relative rights of the parties involved, at length, stating:²⁴

"In analyzing the statute, it would, therefore, appear that the right of the specified majority to sell all the assets, is absolute insofar as the fact of sale and whether one should be made, is concerned. Upon the question of terms and conditions, however, the expediency thereof and whether they are for the best interests of the corporation must be honestly and in good faith considered. While it is the right of the majority to practically desert the corporate venture by selling out its assets, and thereby, in the case of a highly profitable concern, deprive their associates of the opportunity to reap gains in the future by continuing in business, yet this right cannot be exercised except upon terms and conditions that are fair to the corporation. The price to be paid, the manner of payment, the terms of credit, if any, and such like questions, must all meet the test of the corporation's best interest.

"The majority thus have the power in their hands to impose their will upon the minority in a matter of very vital concern to them. That the source of this power is found in a statute, supplies no reason for clothing it with a superior sanctity, or vesting it with the attributes of tyranny. When the power is sought

²³ 120 Atl. 486 (Ct. Chanc., Del., 1923).

²⁴ *Id.* at 491.

to be used, therefore, it is competent for any one who conceives himself aggrieved thereby to invoke the processes of a court of equity for protection against its oppressive exercise. When examined by such a court, if it should appear that the power is used in such a way that it violates any of those fundamental principles which it is the special province of equity to assert and protect, its restraining processes will unhesitatingly issue.

"To what head of equity jurisdiction may, then, the complaining stockholder appeal for protection against what he claims is an inequitable exercise of the power? The requirements of the statute and of the certificate of incorporation all being satisfied, as they are in this case, it will be manifest that the only ground upon which he can base his claim for relief is that of fraud. Notwithstanding that the right of the majority to sell all the assets is given by the statute, yet if the proposed sale is a fraud on the minority, it cannot stand.

"Before examining the facts adduced by the complainants for the purpose of showing fraud, it will be in order first to define the relations which equity will regard as subsisting between the controlling majority members of the corporation and the minority. That under certain circumstances these relations are of a fiduciary character is clear. No one, of course questions the fiduciary character of the relationship which the directors bear to the corporation. The same considerations of fundamental justice which impose a fiduciary character upon the relationship of the directors to the stockholders will also impose, in a proper case, a like character upon the relationship which the majority of the stockholders bear to the minority. When, in the conduct of the corporate business, a majority of the voting power in the corporation join hands in imposing its policy upon all, it is beyond all reason and contrary, it seems to me, to the plainest dictates of what is just and right, to take any view other than that they are to be regarded as having placed upon themselves the same sort of fiduciary character which the law impresses upon the directors in their relation to all the stockholders. Ordinarily the directors speak for and determine the policy of the corporation. When the majority of stockholders do this, they are, for the moment, the corporation. Unless the majority in such case are to be regarded as owing a duty to the minority such as is owed by the directors to all, then the minority are in a situation that exposes them to the grossest frauds and subjects them to most outrageous wrong.

"Accordingly it has been held that if the majority stockholders so use their power to advantage themselves at the expense of the minority, their conduct in that regard will be denounced as fraudulent and the minority may obtain appropriate relief therefrom upon application to a court of equity. But the general language by which this rule is stated is not to be given its widest possible application. For it is not true that every personal advantage which the majority secures is to be regarded as vitiating in character. An examination of the cases to which special attention is directed by the complainants in this connection will disclose that the personal advantage accruing to the majority is in some way derived from, or intimately associated with, the corporate assets themselves."

The court held that there was no fraud insofar as a question of

personal advantage to the majority holders was concerned, stating:²⁵

"My conclusion with respect to this branch of the case is, that the evidence before me fails to disclose such a peculiar and personal interest or advantage to be served by the sale as will, on the principles applicable to the conduct of one who acts in a fiduciary capacity, taint the proposed transaction with fraud, either actual or constructive. Whatever advantage is gained is purely incidental and collateral. This prospect of personal gain, though not thus to be condemned as fraudulent in character, may however be very properly regarded when, as will subsequently appear, the fairness and adequacy of the terms of sale are considered in connection with the present application."

However, the court then went on to consider the adequacy of the price to be paid upon the sale of the assets and issued a temporary injunction pending a determination of the true value of such assets.

ILLINOIS

In *Leopold v. Inland Steamship Co.*,²⁶ the Inland Steel Co. owned the majority of stock in the steamship company. When the minority stockholders refused to sell their stock to the majority holders at \$700.00 per share, the majority holders proceeded to call a meeting for the purpose of voting on whether the corporation should be dissolved. The motive of the majority stockholders in attempting to dissolve the corporation, as reiterated throughout the testimony by directors of Inland Steel Co., was to freeze out the minority holders. Before the meeting was called, the minority holders brought a bill for an injunction, but the court dismissed it as premature since the majority had done nothing but call the meeting. The case came up again²⁷ after the majority had voted to dissolve under a West Virginia Statute and the corporation had already been dissolved and the stockholders had been given their pro rata share of the assets. In this case the minority holders brought a suit for damages. The court granted damages in the amount of the "difference between what plaintiffs have received from the sale of the physical assets and what the stock was really worth as stock in a going prosperous concern continuing in business." The court said:²⁸

²⁵ *Id.* at 493-4.

²⁶ 82 F. (2d) 351 (C. C. A. 7th, 1936).

²⁷ 125 F. (2d) 369 (C. C. A. 7th, 1941).

²⁸ *Id.* 372, 373 and 374.

"The directors of a corporation represent it and its stockholders; the majority stockholders of a corporation represent it and its minority stockholders. The vote of every director and of every majority stockholder must be directed to and controlled by the guiding question of what is best for the corporation, for which he is, to all legal intents and purposes, trustee. In his voting, in his management, he is bound to be wholeheartedly, earnestly and honestly faithful to his corporation and its best interests; his own selfish interests must be ignored. If when he votes he does so against the interest of his company, against the interest of his minority and in favor of his own interest, by such selfish action, by omission of fidelity to his own duty as a trustee, he forfeits approval in a court of equity.

"What defendant might have accomplished under color of the West Virginia statute was discontinuance of the business. What it did, was to take through form of a sale, the physical assets and the entire business of the Steamship Company. Whether we stamp the happenings as dissolution or with some other name, equity looks to the essential character and result to determine whether there has been faithlessness and fraud upon the part of the fiduciary. However proper a plan may be legally, a majority stockholder can not, under its color, appropriate a business belonging to a corporation to the detriment of the minority stockholders. The so-called dissolution was a mere device by means of which defendant appropriated for itself the transportation business of the Steamship Company to the detriment of plaintiffs. That the source of this power is found in a statute, supplies no reason for clothing it with a superior sanctity, or vesting it with the attributes of tyranny. *Allied Chemical & Dye Corp. v. Steel & Tube Co. of America*, 14 Del. 1, 120 A. 486. The books are full of instances of disapproval of such action. If it be an absorption by the dominant member of all the returns of the corporate investment, or a sale of the property to oneself for an inadequate consideration, or deprivation by a syndicate formed to freeze out a minority stockholder through sale and dissolution or if the buyer and seller are the same, the right of a stockholder to vote becomes a power in trust when he owns the majority and assumes and exercises domination and control over corporate affairs. Such majority stockholders' vote 'must not be so antagonistic to the corporation as a whole as to indicate that their interests are wholly outside of the interest of the corporation and destructive of the interests of the minority shareholders.' *Thurmond v. Paragon Colliery Co.*, 82 W. Va. 49, 95 S. E. 816.

"Furthermore it seems to us that defendant may not be permitted to say that there were no values other than those of physical assets. By taking over the assets and by continuing the prosperous business of its former cestui trust defendant has removed itself from the place where it is permissible for it to contend that there is no prosperous business. That there was value over and above physical assets is perfectly obvious from the fact that a prosperous business existed and is still being conducted; that plaintiffs, if they had not been deprived of their interest, would be still sharing in the returns from that business

and that at the present time all the profits of such are being enjoyed by defendant to the total exclusion of plaintiffs."²⁹

IOWA

In *Rossing v. State Bank of Bode*,³⁰ the majority stockholders had dissolved the corporation under an Iowa statute. The Court, in dismissing a bill by the minority stockholders to obtain an interest in the new corporation which purchased the assets of the old one, said:³¹

"We do not go into the question for what the sale will be avoided, because, as the majority had the power to dissolve and wind up and sell to any one, including itself, no fraud in the subsequent sale can affect that original power. When the requisite vote ordered dissolution, the corporation became ipso facto dissolved, no matter what the motive that induced the vote. No actionable wrong can arise from doing by lawful means what there is lawful right to do."

KANSAS

In *Watkins v. National Bank of Lawrence*,³² a national bank was dissolved by the vote of the majority stockholders in accordance with a United States statute. A minority holder brought suit for a receiver. The court, in refusing to appoint a receiver, stated:³³

"The parties who purchase stock in a national bank take it knowing that two thirds of the stock of the bank may at any time vote it into liquidation. This right may be exercised although it may be contrary to the wishes and against the interests, of the owners of the minority of the stock."

The court went on to say that the directors were acting in good faith and with reasonable care and diligence in winding up the business of the bank.

KENTUCKY

In *Kirwan v. Parkway Distillery Inc.*,³⁴ the majority dissolved the corporation under a Kentucky statute because the minority objected to a sale of the assets of the corporation. The

²⁹ Certiorari was denied in 316 U. S. 675 (1942), but in 136 F. (2d) 876 (C. C. A. 7th, 1943), the court held that the lower court's valuation of the stock at \$2,350.00 per share was excessive and thereupon reduced it to \$1,350.00 per share.

³⁰ 165 N. W. 254 (Iowa, 1917).

³¹ *Id.* at 257.

³² 32 Pac. 914 (Kan., 1893).

³³ *Id.* at 915.

³⁴ 148 S. W. (2d) 720 (Ky. Ct. App., 1941).

minority holders sought to obtain the book value of their stock instead of their pro rata share of the funds remaining after the sale of the assets. The court sustained a demurrer to the complaint, stating:³⁵

"It is claimed that the dissolution of Bonnie Bros. corporation subsequent to the contract of sale of its assets was done for the purpose of defeating appellants' rights to the book value of their stock which was more remunerative to them than their proportionate shares of the assets under a dissolution of the corporation. Conceding that to be true, yet the stockholders when voting strictly as stockholders were still within their legal rights. In the case of *Haldeman v. Haldeman et al.*, 176 Ky. 635, 197 S. W. 376, it is pointed out that there is a radical difference when a stockholder is voting strictly as a stockholder and when voting as a director. When voting as a stockholder he has the legal right to vote with a view of his own benefits and is representing himself only; but, a director represents all the stockholders in the capacity of trustee for them and cannot use his office as director for his personal benefit at the expense of the stockholders.

"To the same effect is *Dudley v. Kentucky High School*, 72 Ky. 576, 9 Bush 576. However, fraud may be an exception to these rules, but as we have already stated, no fraud is claimed or relied on in the case at bar."

LOUISIANA

In *Slattery v. Greater New Orleans Realty & Development Co.*,³⁶ the majority voted to dissolve the corporation in accordance with the corporation's charter. The court denied the injunction sought by the minority holders to prevent the dissolution, stating:³⁷

"The petition alleges that the liquidators had no right to sell the assets of the corporation as a whole and at private sale, as directed by the stockholders' meeting. There is no law prohibiting a corporation from selling all of its property at private sale. *Leathers' v. Janney*, 41 La. Ann. 1120, 6 South. 884, 6 L. R. A. 661; *Hancock v. Holbrook*, 40 La. Ann. 53, 3 South. 351; *Pringle v. Construction Co.*, 49 La. Ann. 301, 21 South. 515. In the absence of legal or charter restrictions, the mode of liquidating a solvent corporation is necessarily left to the sound discretion of a majority of the stockholders, acting in good faith in the premises.

"Nothing less than clear proof of fraud and injury, or the violation of some prohibitory law of the state, would justify the court in annulling the sale to the Land Company."

MISSOURI

In the case of *In Re Doe Run Lead Co.*,³⁸ the St. Joseph

³⁵ *Id.* at 723, 724.

³⁶ 55 So. 558 (La., 1911).

³⁷ *Id.* at 559, 560.

³⁸ 223 S. W. 600 (Mo., 1920).

Company, a New York corporation, owned the majority stock in the Doe Run Lead Co., a Missouri corporation. The majority holders voted for dissolution of the corporation and for purchase of the dissolved corporation's assets by the St. Joseph Co. A dissolution proceeding was brought in accordance with the Missouri statute and minority stockholders objected to the dissolution. The court prohibited the dissolution, and after noting that "it is frankly stated that the purpose of the majority stockholders is to effect a consolidation of the Doe Run Lead Company with the St. Joseph Company" and "the Doe Run Company seems to be engaged in a prosperous and promising business," the court said:³⁹

"If two Missouri corporations not engaged 'solely' in manufacturing could not lawfully effect a consolidation, then it seems quite clear on principle that a foreign corporation acting in concert with a domestic corporation, in a proceeding in our courts, based upon the provisions of our statutes, cannot do so, particularly when neither of them is engaged 'solely' in manufacturing.

"We think that the statutes relating to the dissolution of corporations contemplates a dissolution in fact as well as in name. 'Dissolution' is used in its ordinary sense and meaning, and is to be so construed. As defined by Webster, 'dissolution' means, 'act or process of dissolving or breaking up; separation into component parts; disorganization.' 'Consolidation,' by the same authority, is 'solidification; combination; strengthening.' Whether or not a decree of dissolution should be granted in a given case, then (other requirements of the law being satisfied), depends upon the simple question of the good faith of the proceeding, and that is a question to be determined upon the facts of each particular case. A determination of the question of good faith does not necessarily involve an inquiry into the motives of either group of stockholders with reference to the effect of dissolution upon themselves or upon the other group. By saying that the proceeding must be in good faith, we mean that it must appear upon the face of the record (using that term in its broad sense) that the suit for dissolution is such a suit as is contemplated by our statutes; that is, that the dissolution sought must be a bona fide dissolution intended to culminate in a cessation of corporate life and a distribution of corporate assets. Anything else is a fraud upon the law which the courts will not countenance. If our statutes relating to the consolidation and dissolution of corporations are not sufficiently elastic to meet the needs of modern business, relief from that evil must be sought through new legislation rather than through an erratic and dubious construction of existing laws. In the case in hand we think (speaking in legal phraseology, and not as implying moral obliquity) that the proceeding is not in good faith. It is an attempt to use the law of dissolution as a law of consolidation. This cannot be done. This view has been sustained in other jurisdictions upon reasoning so terse, lucid, and comprehensive, and upon

³⁹ *Id.* at 611-12.

facts so closely analogous, that we feel justified in adopting the arguments as our own, and we therefore quote liberally from them."

NEW HAMPSHIRE

In *Bowditch v. Jackson Co.*,⁴⁰ the court said⁴¹

"The main question in this case is whether a going business corporation can be closed out and dissolved upon the motion of the majority of its stockholders and against the protest of the minority. The question is a new one in this state, although it has frequently been considered (both in cases where it was necessarily involved and those where it was not) by the courts in other states. The decisions and dicta are conflicting and are quite evenly divided. In the following cases the existence of the power is denied, though in most of them the question was not necessarily involved: *Abbot v. Rubber Co.*, 33 Barb. (N. Y.) 578; *People v. Ballard*, 134 N. Y. 269, 32 N. E. 54, 17 L. R. A. 737; *Kean v. Johnson*, 9 N. J. Eq. 401; *Forrester v. Mining Co.*, 21 Mont. 544, 55 Pac. 229, 353. That the power exists is decided or declared in other cases. *Treadwell v. Company*, 7 Gray (Mass.) 393, 66 Am. Dec. 490; *Phillips v. Company*, 21 R. I. 302, 43 Atl. 598, 45 L. R. A. 560; *Black v. Canal Co.*, 22 N. J. Eq. 130, 404 (overruling *Kean v. Johnson*, 9 N. J. Eq. 401); *Merchants', etc., Line v. Waganer*, 71 Ala. 581; *State v. Company*, 115 Tenn. 266, 89 S. W. 741, 2 L. R. A. (N. S.) 493, 112 Am. St. Rep. 825; *Tanner v. Railway*, 180 Mo. 1, 79 S. W. 155, 103 Am. St. Rep. 534; *Arents v. Company* (C. C.) 101 Fed. 338.

"The action taken by a majority of the stockholders of the Jackson Company whereby, as a part of the process of winding up the company, they voted to sell all its property to the Nashua Company, was within the power impliedly given to them when the company was formed. The charges that there was fraud in the sale and that it was for an inadequate price have been disproved. Two other causes of complaint remain to be considered."

NEW JERSEY

In *Windmuller v. Standard Distilling & Distributing Co.*,⁴² the directors resolved to dissolve the corporation, whereupon the minority holders brought a bill to enjoin a vote between stockholders on the question of dissolution. In denying the injunction, the court said:⁴³

"I have not been referred to any authority which holds that one stockholder is in any sense a trustee for other stockholders, or that he is debarred from voting on his stock according to what he may conceive to be his interest, or in a way which may result in a benefit to himself, and which other stockholders may not enjoy. Directors, by whomsoever elected, are the representatives of all the stockholders, and, as such, are charged with the duty of administering the affairs of the company for

⁴⁰ 82 Atl. 1014 (N. H., 1912).

⁴¹ *Id.* at 1016 and 1018.

⁴² 114 Fed. 491 (C. C., N. J., 1902).

⁴³ *Id.* at 494-5.

the equal benefit of their *cestuis quo trustent*. But the doctrine is new that the stockholders are trustees one for another, or that an interest of one stockholder, which in the judgment of another stockholder may seem to be adverse to his own, can operate to prevent him from voting on his own stock as he sees fit.

"The court cannot be called upon to manage the internal affairs of corporations, or to determine whether this or that stockholder is disqualified from voting upon one or another question which may be presented to the stockholders for their consideration by reason of his own interest. If the directors, who are the trustees of all, conspire with a few or some of the stockholders to deprive the others of their property, the court will interfere to see that justice is done. The court will not permit the directors to divert the business of the corporation so that a sale and sacrifice of its assets will become obligatory, and the distribution of the proceeds unequal among its shareholders.

"No case has been brought to the attention of the court where any stockholder has been deprived of his right to vote on his stock in such a way as may, in his opinion, best subserve his own interests.

"In the case at bar the court is not in possession of facts which would enable them to determine whether the interests of the corporation, as distinct from the interests of the individual shareholders, require that it should be dissolved. Under the general corporation act of the state of New Jersey, any corporation may be dissolved whenever in the judgment of the board of directors it shall be deemed advisable and most for the benefit of such corporation that it should be dissolved; provided that, at a meeting of the stockholders called for the purpose of passing upon the propriety of such dissolution, two-thirds in interest of all the stockholders shall consent thereto. Laws 1896, c. 185. There is no provision in the law which authorizes the court to review the judgment of the directors as to the advisability of dissolution."

In *Barrett v. Bloomfield Savings Institution*,⁴⁴ a bank was dissolved by its directors in accordance with a New Jersey statute. The court, in granting a temporary injunction, said:⁴⁵

"This brings me to the principal question, and that is: Have the defendants been guilty of any breach of trust? And that leads to an examination of the question—which, however, seems to me really to need no examination—of the real relation which the managers of this and other savings institutions bear to the public and to the depositors. And I will say at once, before citing the authorities, that I had supposed that, if anything was perfectly well settled in New Jersey, it was that the managers of a savings institution occupied the position of trustees of the depositors; and I think an examination of the authorities shows that their position is of even a higher grade than that: They are trustees of a public franchise granted to and held and exercised by them for the benefit of the public at large, and especially that part of the public in the immediate neigh-

⁴⁴ 54 Atl. 543 (Ct. Chanc., N. J., 1903), aff'd. per curiam, 57 Atl. 1131 (N. J. Ct. Err. and App., 1904).

⁴⁵ *Id.* at 546 and 549.

borhood of the location of the particular institution, as well as for the depositors in their institution.

"The defendants assert that they are justified in what they have done by the language of the act of April 9, 1902 (P. L. 1902, p. 677). That act authorizes them to dissolve the institution, if, at a meeting of the managers called to consider the question, 'a resolution declaring the dissolution of said institution to be advisable be passed by a two-thirds vote of the whole board.' The meaning of the word 'advisable' is sufficiently clear and simple. That is 'advisable' which is expedient, prudent, and proper to be done, and therefore proper to be advised to be done. Its synonyms, according to Webster, Worcester, and the Century Dictionary, are 'expedient,' 'proper,' 'desirable,' 'prudent,' 'wise,' 'best.' It seems clear to my mind that in the act here in question the word 'advisable' includes those qualities as applied to the continuance of the existence of the defendant corporation in view of the interests of the public generally, as well as in the interests of that portion of the public in the immediate neighborhood of Bloomfield. I am unable to conceive that the Legislature intended that the managers, in judging upon and determining such advisability, should take into consideration their own individual interests or that of their friends, or even act from mere indifference, or a desire to be relieved from the duties of their offices. In my judgment, the only considerations which the Legislature intended should influence their judgment are the interests of the public."

In *Bijur v. Standard Distilling & Distributing Co.*,⁴⁶ the corporation had been dissolved by its stockholders under the New Jersey statute. Minority preferred stockholders, whose stock had indorsed on its face a guarantee of dividends for the entire period for which the corporation was organized, brought suit for dividends accruing after the dissolution of the corporation. Prior to the suit the same minority holders had brought a bill in equity for the appointment of a receiver of the corporation. The court, in dismissing the bill, said:⁴⁷

"The rule allowing stockholders of a company the option to avoid contracts or agreements made by common directors, on behalf of both companies, and which is applied in proper cases where the contract, finally binding the company and all its stockholders, is made through the directors alone, has no application to the action of directors in those statutory proceedings where the final action is that of the stockholders themselves, acting, as they are entitled to act, in their individual rights, and, if they choose, according to their individual interests.

"Nor has the charge of fraud in the passage of the resolution been at all made out. On the contrary, the evidence of the witnesses called by complainant on this hearing to testify in relation to the passage of the resolution for dissolution disproves the charge, and on the hearing and in the briefs the evidence mainly

⁴⁶ 70 Atl. 934 (Ct. Chanc., N. J., 1908), aff'd. per curiam, 81 Atl. 1132 (N. J. Ct. Err. and App., 1911).

⁴⁷ *Id.* at 937.

relied on to support the charge is that of the reports of the several companies and the financial condition of the company as inferred from these reports. These statements do not justify such inference. But as to all of the objections to the dissolution of the Distributing Company, based on the alleged fraud of the Standard Company as one of the stockholders, acting through its own directors, I think the complainants are concluded by the bill and proceedings in their own suit in chancery above set forth, in which they accepted the dissolution, took proceedings to carry it into effect, and procured a final decree distributing its assets among all its stockholders, including as well the Standard and Distributing Company as themselves. The decree is set up in the answer as *res adjudicata*, and it must therefore be given full effect on all the matters foreclosed by it. The claim of complainants against the Standard Company, therefore, must depend upon the contract, and this is the ground upon which the claim is mainly placed by the bill; the allegation of fraud in the proceedings for dissolution being set up apparently only as an alternative answer or basis of relief, in case the contract be construed as terminated merely by the dissolution of the Distributing Company."

In *William B. Riker & Son Co., v. United Drug Co.*,⁴⁸ the directors of the corporation adopted a resolution to dissolve it. In notifying the stockholders of the calling of a meeting to vote on dissolution, the directors frankly stated that the dissolution was part of a plan for the reorganization of the company and was meant to accomplish the following results: First, to provide additional capital; second, to give preferred stockholders the option of exchanging preferred stock for common stock; and, third, the elimination of four subsidiary companies. The plan contemplated the transfer of all the assets of the corporation to a new company organized under the laws of Michigan. Before the stockholders meeting was held, minority stockholders brought suit to enjoin a vote on dissolution. The court, in denying the injunction, said:

"The meeting for the purpose of acting upon the *first* resolution, relative to dissolution, has been duly called, and the power and right is expressly given by the statute to the stockholders to take action on such resolution and consent to the dissolution by a two-thirds vote, and consent in writing.

"The stockholders at this meeting act, not as trustees for each other, but individually, and have the right to vote as their views of their individual interests may dictate, subject to the qualification hereafter stated.

"The New Jersey cases settling the nature of the rights of stockholders at stockholders' meetings are referred to in some cases that have been before me, especially the *Colgate Case*, 73 N. J. Eq. 72, 67 Atl. 657, which was a case of consolidation and merger, and the *Bijur Case*, 74 N. J. Eq. 546, 70 Atl. 934, a case

⁴⁸ 79 Atl. 1044 (Ct. Chanc., N. J., 1911).

of dissolution. The latter case is now pending before the Court of Errors and Appeals, and it is possible some qualifications of the rights as previously declared may be made. This right to take action on the resolution for dissolution is conferred by statute in express terms, without any express terms of qualification.

"It is contended on the part of the complainants that there are provisions in the statutes relating to corporations which have the effect of qualifying this right. These provisions are those defining the effect of dissolution and directing the proceedings that are to be taken for winding up on dissolution. It is contended that those have the effect of qualifying this power, and that on a proposed dissolution the court may examine whether, in reference to the steps intended to be taken, they are such as are directed or intended by the statute, and, if not, may enjoin the entire proceedings for dissolution, including a vote on the resolution. I think that is a wrong view of the effect of those provisions. Those provisions are effective; but they are not effective by way of qualifying the right to dissolution. They are effective by way of preventing any plan being carried out subsequent to the dissolution which is not in compliance with the terms of the statute; but the court should not undertake in advance to say that the right to vote on the question of dissolution must be taken away, for the reason that in voting on this question they do so with the motive, or the object, of carrying out certain plans which would be in violation of the statute relating to proceedings after dissolution. For if the plans are violations of the statute, they cannot be carried out after dissolution, and the stockholders, in voting to dissolve, take that risk of their being carried out.

"I conclude, therefore, that these other provisions of the corporation act relating to the effect of dissolution and the proceedings on dissolution have not the effect of qualifying the right or power of a stockholder to vote on the resolution for dissolution. It is undoubtedly true that the dissolution could not be used by the majority for the purpose of committing a fraud on the minority stockholders, but in the absence of fraud, or acts beyond their lawful powers as stockholders, the minority have, as I think, no standing to enjoin the exercise of this right conferred by statute on the majority stockholders.

"The circumstance that one motive or reason for the dissolution of the company may be a termination of rights given by a by-law of the company to the stockholders does not of itself make the proceedings for dissolution a fraud on the minority stockholders. It is often found, in the organization of companies, that provisions are adopted either by way of express contracts in the stock itself, or in the by-laws, that operate in a way far different from what the promoters or original organizers of the company expected, and in many cases it is a matter of pure business reason and judgment, not at all involving any question of fraud, whether the company should consider the advisability, in a business point of view, of taking into account, in the dissolution of the company, the termination of contracts, leaving the assets of the company subject to any liability therefor. In the *Bijur Case*, as I recall it, one of the reasons mostly relied on for a dissolution of one of the companies was that, in its original charter or contracts made under it, there had been provisions for contracts of such an onerous character that, if carried out, it

eventually must injure the business of the company materially. So far, therefore, as it is a business reason, the stockholders have a right to consider the effect of the by-law and its continuance. The circular does not state expressly that the termination of this by-law is one of the objects of the plan of reorganization; but I think, in view of the fact that the Massachusetts company is organized on a plan by which the by-law is omitted, the complainants as well as the defendant in this case are entitled to consider the elimination of this by-law as one change in the status of the company in the reorganization of its affairs proposed. My view in reference to the right to terminate rights conferred by a by-law is that the by-law, considered merely as such, is made subject to determination by dissolution of the company, under the laws that were in force at its adoption.

"The fact that the dissolution is recommended by the directors, or may be intended by the majority stockholders in giving consent to it, as one step in a proceeding to reorganize the financial and business affairs of the company, does not of itself make the proceedings either fraudulent or colorable under the statute.

"On the affidavits in this case as presented to me, it cannot be said that they disclose merely a colorable dissolution or plan of reorganization."

The above case was later reversed⁵⁰ on the sole ground that the proposed dissolution was in reality a consolidation of the New Jersey and Massachusetts corporations, and since the New Jersey law did not permit a consolidation of the merger of a domestic and a foreign corporation, the court permitted an injunction to be issued, stating:⁵¹

"Manifestly the prime purpose of the scheme outlined in this communication is not the winding up of the New Jersey corporation and the distribution of its assets, or the proceeds of the sale thereof, among its stockholders, but the absorption of that company by the Massachusetts corporation, the transfer, not only of its assets, but of its business, to that corporation, and the future carrying on of that business by the Massachusetts corporation under the name of the defendant company. The scheme, in its essence, whatever it may be in form, is not a plan for the reorganization of the New Jersey company, nor even for the winding up of its business and its dissolution, within the meaning of the latter word as used by our Corporation Act, but is a scheme for its merger into or consolidation with the Massachusetts corporation. *State v. Atlantic City & Shore R. R. Co.*, 77 N. J. Law 466, 483, 72 Atl. 111.

"Consequently the fundamental question now to be decided is whether a corporation of this state, organized under our general Corporation Act, may legally be merged into or consolidated with a corporation created by and organized under the laws of a sister state. The answer to this question seems to us not to be in doubt. As was said by this court in *Colgate v. United States Leather Co.*, 75 N. J. Eq. 229, 72 Atl. 126, 19 Ann Cas. 1262, the power of corporations to consolidate and merge is not to be

⁴⁹ *Id.* at 1045-6.

⁵⁰ 82 Atl. 930 (N. J. Ct. Err. and App., 1912).

⁵¹ *Id.* at 931.

implied, and exists only by virtue of plain legislative enactment; and no statute of our state can be found which authorizes the proposed scheme.

"The only right given by our Legislature to two or more corporations to merge or consolidate into a single corporation is expressly limited to those which are organized under the laws of our own state. Revised Corporation Act, § 104 (P. L. 1896, p. 309). The proposed plan for the so-called 'reorganization' of the defendant company is therefore in violation of the law of the state, whose creature it is; and, this being so, any stockholder who refuses to consent thereto is entitled to the aid of a court of equity to prevent its being carried into execution. Each stockholder of the company owns a share in its property and assets, and is entitled to have a proportionate share in its profits. They have invested their capital in it, and in it alone; and they are entitled to every dollar that it earns. This is the agreement of the stockholders among themselves. They each contract with the other that their money shall be employed for the purposes specified in the certificate of incorporation, and for no other purpose, and that the profits of the enterprise shall be ratably apportioned among them. In the absence of legislation permitting a variation of the provisions of this fundamental contract by vote of a majority of the stockholders, no majority, however large, has a right to divert any part of the joint capital, however small, to any purpose not consistent with and growing out of this original, fundamental agreement. *Black v. Delaware & Raritan Canal Co.*, 24 N. J. Eq. 456, 463; *Mills v. Central R. R. Co. of N. J.*, 41 N. J. Eq. 1, 2 Atl. 453; *Colgate v. United States Leather Co.*, *supra*.

"The scheme in the carrying out of which the dissolution of the company is a proposed step, is a fraud upon the statute (the word is used in a legal, not a moral, sense); and every act done in furtherance thereof, no matter whether it be legal, standing alone, or not, is equally a fraud upon the statute. This being so, the complainants were entitled to an injunction to restrain the proposed invasion of their rights under the contract of incorporation as soon as it was made manifest that such invasion was in fact contemplated."

In *Reade v. Broadway Theatre Co., of Long Branch*,⁵² in a suit by an owner of about one-half of the corporate stock for the appointment of a receiver on the ground that the executors of an estate which owned the other half of the corporate stock refused to sell such interest to him, the court, in dismissing the action, said:⁵³

"A voluntary dissolution may be had only in the method prescribed by statute, or, if through the courts, where it appears for the best interests of the stockholders and creditors; but a court of equity will not permit the dissolution of a corporation even on application of the majority of the stockholders where such dissolution would constitute a fraud on the minority."

⁵² 132 Atl. 477 (Ct. Chanc., N. J., 1926).

⁵³ *Id.* at 480.

In *Beach v. Wharton Mining Co.*,⁵⁴ the corporation was dissolved under the New Jersey statute and its assets were sold to a new corporation organized by a creditor of the old corporation. A suit for the determination of minority stockholders' rights in the property of the old corporation held by the new one was dismissed, the court saying:⁵⁵

"Appellant argues that the whole procedure by which the property was sold to the Wharton Mining Company was a fraud upon the statute under which the trustees in dissolution were winding up the affairs of the Hoff Co.; that Arend's and not the corporation's interest was alone considered. The Vice Chancellor did not find, nor do we find any fraud upon the statute, or otherwise. As to the main issue involved in this case, namely, whether there was any consideration for the conveyance, the Vice Chancellor found against complainant. With this finding we are in accord.

"The testimony shows that the dissolution of the Hoff Co. was accomplished in strict accordance with Section 31 of the Corporation Act, Comp. Stat. 1910, p. 1619, N. J. S. A. 14:13-1. While it is true that Arend might have brought suit to foreclose his mortgages or have sought the benefit of Section 65 and 66 of said Corporation Act, N. J. S. A. 14:14-3, 14:14-4, 14:14-5, 14:14-7, yet neither of these proceedings was mandatory and under neither of them would appellant have been in any better position than upon dissolution of the Hoff Co. under its directors. In fact, costs and fees were saved thereby."

NEW YORK

In *Ervin v. Oregon Ry. & Nav. Co.*,⁵⁶ the majority dissolved a corporation in accordance with an Oregon statute and transferred its assets to a new corporation. The court gave the minority holders an equitable lien on the property of the old corporation in the hands of the new corporation, stating:⁵⁷

"They never contemplated winding up the business of the old company, and distributing the assets among its stockholders, otherwise than as a formal mode of doing what they could not do by legal sanction. What they intended to do, and what they practically did, was to effect a consolidation of the old company with the new, using as the means for the end the statutory power which authorizes a majority of stockholders to dissolve the corporation, settle its business, and dispose of its property.

"Plainly, the defendants have assumed to exercise a power belonging to the majority, in order to secure personal profit for themselves, without regard to the interests of the minority. They repudiate the suggestion of fraud, and plant themselves upon their right as a majority to control the corporate interests

⁵⁴ 15 A. (2d) 605 (N. J. Ct. Err. and App., 1940).

⁵⁵ *Id.* at 607.

⁵⁶ 27 Fed. 625 (C. C., N. Y., 1886).

⁵⁷ *Id.* at 629, 630-1.

according to their discretion. They err if they suppose that a court of equity will tolerate a discretion which does not consult the interests of the minority.

"It cannot be denied that minority stockholders are bound hand and foot to the majority in all matters of legitimate administration of the corporate affairs; and the courts are powerless to redress many forms of oppression practiced upon the minority under the guise of legal sanction, which fall short of actual fraud. This is a consequence of the implied contract of association, by which it is agreed, in advance, that a majority shall bind the whole body as to all transactions within the scope of the corporate powers. But it is also of the essence of the contract that the corporate powers shall only be exercised to accomplish the objects for which they were called into existence, and that the majority shall not control those powers to prevent or destroy the original purposes of the incorporators. * * * It is for this reason that the majority cannot consolidate the corporation with another corporation, and impose responsibilities and hazards upon the minority not contemplated by the original enterprise, unless express statutory authority for this purpose is conferred upon the majority. It is no more repugnant to the purposes of the association to permit the majority to merge and consolidate the corporation with another corporation than it is to permit them to dissolve it, and abandon the enterprise for which it is created, when no reasons of expediency require this to be done. A dissolution under such circumstances is an abuse of the powers delegated to the majority. It is no less a wrong because accomplished by the agency of legal forms."

In *Elbogen v. Gerbereux-Flynn Co.*,⁵⁸ the majority dissolved the corporation under statutory authority. The court, in a brief opinion, denied an injunction by the minority stockholders on the ground that no fraud had been shown.

In *Kuickerbocker v. Groton Bridge & Mfg. Co.*,⁵⁹ the majority dissolved a corporation under a New York statute. The minority stockholders brought suit for an involuntary dissolution of the company. The court held that the complaint did not state a cause of action, stating:⁶⁰

"The further allegation as to the purpose for which these proceedings were instituted is not the allegation of a fact which justifies a judgment declaring them void. The mere motive of the directors in instituting proceedings is entirely immaterial. If the proceeding was conducted according to the statute, if the steps required by the statute to dissolve the corporation were taken, and the corporation thereby became dissolved, certainly the proceedings cannot be vacated because the plaintiff alleges that the motives of the directors were fraudulent. I think, therefore, that the complaint does not state facts sufficient to constitute a cause of action."

⁵⁸ 64 N. Y. S. 1 (Sup. Ct., App. Div., 1900).

⁵⁹ 97 N. Y. S. 595 (Sup. Ct., App. Div., 1906).

⁶⁰ *Id.* at 599.

In *Colby v. Equitable Trust Co. of New York*,⁶¹ the court, in denying an injunction sought by the minority holders where the majority holders had voted for a merger under statutory authority, said:⁶²

"If a large majority of the stockholders of the Equitable Company deemed it for their respective interests to liquidate the company, and proceedings in good faith were about to be taken in accordance with the statute for that purpose, no one, I take it, would seriously contend that a court of equity ought to interfere and prevent such liquidation."

In the case of *In Re Rateau Sales Co.*,⁶³ an order for the voluntary dissolution by the majority under statutory authorization of a corporation was reversed by the court because the referee failed to give the minority stockholders an opportunity to prove that the majority stockholders were dissolving the corporation to wreck it and to avoid the performance of valuable contracts which it had. The court said:⁶⁴

" * * * but all the papers taken together constituted legitimate evidence bearing upon the question whether it was 'beneficial to the interests of the stockholders that the corporation should be dissolved.' Gen. Corp. Law (L. 1909, c. 28; Cons. Laws, c. 23) § 170. Upon this question the interests of the minority stockholders, as well as those of the majority, are entitled to be considered."

One of the leading cases in the field of minority rights in dissolution is *Kavanaugh v. Kavanaugh Knitting Co.*,⁶⁵. Several members of a family corporation desired to oust one of the members of the family, who was the vice president of the corporation. In order to do this, the by-laws were amended to provide that a majority, instead of all, of the directors should constitute a quorum at any meeting and to provide that the directors by a majority vote could remove any officer of the company either with or without cause. The vice president was thereupon forced to resign. After his resignation, the directors adopted a resolution fixing each of their salaries at 20 per cent of the profits of the corporation. The compensation so voted was clearly unfair and unreasonable, and enormously greater than was paid for

⁶¹ 108 N. Y. S. 978 (Sup. Ct., App. Div., 1908), aff'd. per curiam, 84 N. E. 1111 (N. Y. Ct. App., 1908).

⁶² *Id.* at 984.

⁶³ 94 N. E. 869 (N. Y. Ct. App., 1911).

⁶⁴ *Id.* at 871.

⁶⁵ 123 N. E. 148 (N. Y. Ct. App., 1919).

similar services by similar corporations. Thereupon the ousted member brought an action to enjoin the payment of the compensation so voted. In response to this suit, the directors voted to dissolve the corporation under a New York law which permitted such dissolution by the majority of the stockholders upon a resolution by the directors that it is "in their opinion advisable to dissolve such corporation." Thereupon the ousted member sought to enjoin the majority from dissolving the corporation. The court held that the complaint for an injunction stated a cause of action. The court said:⁶⁶

"The resolution of the board of directors, in order that it be legal, must be the embodiment in language of the opinion or judgment of the board, attained in good faith and through honest intention and endeavor, that, having in view the welfare and advantage of the corporation and the stockholders generally, it is wise and expedient that the corporation be forthwith dissolved. The unwisdom or incorrectness of the opinion or judgment does not affect its validity or integrity. The fact that the dissolution may not be beneficial or may be injurious to a stockholder or stockholders because of reasons or facts not common to the stockholders generally need not be considered by the directors. The law, as well as ordinary justice and sound business policy, requires that the existence of the corporation should not be attacked, within the period fixed by its charter, by its board of directors acting in bad faith, fraudulently, or through the intent to punish or oppress a stockholder because he defends himself in the courts or otherwise against their illegal and unfair acts relative to the corporation or because of any other reason.

"The section 221 imposes upon the stockholders the ultimate determination of the important question whether or not the corporation shall be dissolved forthwith. The stockholders are bound to determine and control this particular part of the corporate affairs, in regard to which they occupy a relation of trust as between themselves and the corporation, and are burdened and restricted by fiduciary obligations. When a number of stockholders constitute themselves, or are by the law constituted, the managers of corporate affairs or interests, they stand in much the same attitude towards the other or minority stockholders that the directors sustain generally towards all the stockholders, and the law requires of them the utmost good faith. * * * In taking corporate action under the statute, the stockholders are acting for the corporation and for each other, and they cannot use their corporate power in bad faith or for their individual advantage or purpose.

"A court of equity will protect a minority stockholder against the acts or threatened acts of the board of directors or of the managing stockholders of the corporation, which violate the fiduciary relation and are directly injurious to the stockholders. The statute empowered the directors and stockholders, under the prescribed procedure, to dissolve the corporation. The plaintiff took his stock subject to the provisions of the stat-

⁶⁶ *Id.* at 151-2.

ute. Judicial authority does not extend to enjoining the exercise of a right conferred by legislative authority. The courts cannot pass upon the question of the expediency of the dissolution; for that is the very question which the Legislature has authorized the board of directors and the stockholders to decide. They can, however, and will, whenever the facts presented to them in the appropriate action demand, inflexibly uphold and enforce, in accordance with established equitable principles, the obligations of the fiduciary relation. The good faith of the individual defendants is a proper and fundamental subject to be adjudged. Bad faith, fraud, or other breach of trust constitutes a foundation for equitable relief.

"The respondents argue that the complaint fails to state a cause of action because it fails to state facts composing fraud on the part of the directors. In this they err. It is apparent that the cause of action sought to be alleged has not as a constituent deceit or actual fraud practiced and effected by the board of directors in regard to the corporation by which the plaintiff is to be wronged. The plaintiff's complaint is that the individual defendants who were the board of directors did not form the opinion that it was advisable to dissolve the corporation forthwith in good faith and through honest intention and endeavor. We need not state a detailed analysis of the contents of the complaint. Obviously, facts are alleged which permit, if they do not compel, the inference that the directors conceived and progressed the scheme of dissolving the corporation, irrespective of the welfare or advantage of the corporation and of any cause or reason related to its condition or future, through the desire and determination to take from the corporation and to secure to themselves the corporate business freed from interference or participation on the part of the plaintiff. Moreover, allegations of the complaint are, in effect, that the judgment or opinion of the directors was not honest, their action was not the directors was not honest, their action was not the result of good faith, the exercise of an honest judgment, and an honest and unbiased consideration of any fact or circumstances affecting the general interests of the corporation and of all of its stockholders, and was in bad faith and for the sole purpose of permitting the individual defendants Kavanaugh to dissolve the corporation for the purpose of depreciating the value of the corporate property and the plaintiff's proportionate interest therein. Those allegations are matters of fact. Good faith or bad faith as the guide or the test of fiduciary conduct is a state or condition of mind—a fact—which can be proved or judged only through evidence. The intent or unconscientious indifference is the vitality of each."

In *Major v. American Malt & Grain Co.*,⁶⁷ the majority stockholders voted to dissolve the corporation under a New Jersey statute. A minority holder brought an action which the court held to be sufficient to entitle him to an accounting, but the court went on to hold that he had no right to bring a rep-

⁶⁷ 181 N. Y. S. 152 (Sup. Ct., Spec. Term, Kings County, 1920).

representative action without making the liquidating trustees parties to such action. The court said:⁶⁸

"These individual defendants by virtue of their voting power were in the same position as majority stockholders. They could use that power for the good or evil of the corporate interest and that of the stockholders. It seems to me they may be held just as accountable as if they actually owned the stock. Courts will not interfere with the power belonging to majority stockholders to pass upon the advisability of a dissolution. But the majority interests occupy a fiduciary relation toward the corporation and the other stockholders, and are required to exercise the utmost good faith, which is a subject for consideration by a court of equity. Relief can be found in equity for their bad faith, fraud, or other breach of trust. *Kavanaugh v. Kavanaugh Knitting Co.*, 226 N. Y. 185, 123 N. E. 148. This complaint shows that the individual defendants in violation of their quasi trust duty have placed the plant, other properties, and good will of the New Jersey corporation in the hands of the Delaware corporation, without any payment for that good will; they practically made a Delaware corporation out of the New Jersey corporation, to the exclusion of the common stockholders. All this was done, not for the best interests of the New Jersey corporation or its stockholders, but was solely and only for the uses and purposes of all of the defendants."

In *St. John of Vizzini v. Cavallo*,⁶⁹ the court held that the by-laws of a corporation to the effect that the corporation would continue in existence as long as ten members desired it are not superseded by a New York statute permitting dissolution by the vote of the holders of two-thirds of the stock and also held that a two-thirds vote to dissolve was thus ineffective. The court said:⁷⁰

"Moreover, even acting in accordance with the letter of the statute the two-thirds majority must act in the utmost good faith * * * and it is extremely doubtful whether their conduct to the minority displays such good faith."

In the case of *In Re American Telegraph and Cable Co.*,⁷¹ the majority voted to dissolve the corporation. In the subsequent court proceedings to dissolve, the court ordered the dissolution only on the condition that the corporation retain enough funds for payment to the minority stockholders in the event that the sale price of the assets would be held to be inadequate. The court said:⁷²

"Here, however, the transaction was approved by a large majority of the stockholders, including such a majority of those

⁶⁸ *Id.* at 153-4

⁶⁹ 234 N. Y. S. 683 (Sup. Ct., Spec. Term, N. Y. County, 1929).

⁷⁰ *Id.* at 684.

⁷¹ 248 N. Y. S. 98 (Sup. Ct., Spec. Term, N. Y. County, 1931).

⁷² *Id.* at 100-101, 102.

not interested in the purchaser. If the stockholders not interested in the purchaser are thus divided, a minority stockholder cannot avoid the sale as a matter of right, but only where suitable grounds exist. Although the learned referee took proof at great length, there was no attempt by the objecting stockholders to establish fraud other than to attack the adequacy of the price paid. Proof of a price clearly inadequate might establish lack of fairness or good faith by those who controlled the sale when the same directors acted for both parties. The decision of the referee did not include a decision of the question as to whether the price was adequate. That appears to be the essential question in the stockholders' action to set aside the sale.

"The court must, in order to determine good faith, consider the fairness of the price paid. As was said in *Colby v. Equitable Trust Co.*, 124 App. Div. 262, 263, 108 N. Y. S. 978, 985, "That question must necessarily under the statute be determined by the stockholders themselves, and, once their decision has been made, in the absence of fraud or bad faith, or of facts clearly showing that the proposed acts will be oppressive or unfair to the corporation, the court cannot and ought not to interfere."

In *Welt v. The Beachcomber, Inc.*,⁷³ the majority stockholders voted to dissolve the corporation, but a minority holder obtained an injunction. Shortly before the injunction was obtained, the corporation transferred all of its assets to another corporation controlled by the majority stockholders. The court held this transfer to be null and void, stating:⁷⁴

"That the individual defendants have in effect transferred all the assets, including cabaret license, lease, and good will of the defendant corporation to a new corporation practically owned and controlled by them, is conceded. The court finds a proper basis for plaintiff's claim that this was not done in good faith, but for the purpose of destroying plaintiff's rights in the defendant corporation. The defendants by so doing have caused a de facto dissolution of the defendant corporation. *People v. Ballard*, 134 N. Y. 269, 32 N. E. 54, 17 L. R. A. 737; *Abbot v. American Hard Rubber Co.*, 33 Barb. 578; *Major v. American Malt & Grain Co.*, 110 Misc. 132, 181 N. Y. S. 152. The directors may not thus, in bad faith, cause a dissolution of the corporation as against dissenting stockholders. *Godley v. Crandall & Godley Co.*, 212 N. Y. 121, 105 N. E. 818, L. R. A. 1915D, 632; *Abbot v. American Hard Rubber Co.*, *supra*."

NORTH CAROLINA

In *White v. Kincaid*,⁷⁵ the directors had passed a resolution under a North Carolina statute to the effect that they deemed it "advisable and most for the benefit of the corporation that it

⁷³ 1 N. Y. S. (2d) 177 (Sup. Ct., Spec. Term, N. Y. County, 1937).

⁷⁴ *Id.* at 179-80.

⁷⁵ 63 S. E. 109 (N. C., 1908).

should be dissolved." A minority stockholder sought an injunction, but the court dismissed the bill, stating:⁷⁶

"As far as North Carolina is concerned, that statute settles the question formerly much mooted in the courts as to whether, and under what circumstances, a corporation could be dissolved by the stockholders, when no time was fixed for its duration, upholding and extending this power of voluntary dissolution as established by the better considered decisions on the subject. *Black v. Canal Co.*, 22 N. J. Eq. 130-404; *Treadwell v. Salisbury Mfg. Co.*, 7 Gray (Mass.) 393, 66 Am. Dec. 490. This regulation enters into every charter, subject to the provisions of the statute; and, unless otherwise specially enacted by the Legislature, every stockholder takes and holds his stock subject to this power of voluntary dissolution by resolution of the directors, concurred in by two-thirds in interest of the stockholders. This being the law governing the interest of these parties, when the board of directors of a corporation have determined, in the exercise of their best judgment, that the corporation be dissolved, and are pursuing the methods specified by the statute, it is only in rare and exceptional instances that their action should be stayed or interfered with by the courts. It is a principle well established that, when a person, corporate or individual, is doing a lawful thing in a lawful way, his conduct is not actionable, though it may result in damage to another; for, though the damage caused is undoubted, no legal right of another is invaded, and hence it is said to be *damnum absque injuria*. *Dewey v. Railroad*, 142 N. C. 392-408, 55 S. E. 292; *Thomason v. Railroad* (plaintiff's appeal), 142 N. C. 318, 55 S. E. 205; *Oglesby v. Attrill*, 105 U. S. 605, 26 L. Ed. 1186. In such cases the motive prompting the act, however reprehensible or malicious, is not as a rule relevant to the inquiry; nor will courts undertake to interfere with the honest exercise of discretionary powers vested by statute in the management of a corporation, however unwise or improvident it may seem. *Windmuller v. Distilling Co.* (C. C.) 114 Fed. 491. " * * * if it clearly appears that the action of the management is in bad faith; that the resolution for dissolution, for instance, has been superinduced by fraud or undue influence, or if it could be clearly established that this resolution was not taken for the benefit of the corporation, or in furtherance of its interest, but for the mere purpose of unjustly oppressing the minority of the stockholders, or any of them, and causing a destruction or sacrifice of their pecuniary interests or holdings, giving clear indication of a breach of trust—such action could well become the subject of judicial scrutiny and control.

"Such cases almost invariably arise when the management of a solvent concern, going and prosperous, ceases operations and determines to dissolve and sell out, with a view of continuing the same or similar business under different control, and when there is indication given that the sole purpose was to oppress some of the stockholders and confiscate their holdings, or when it is done in furtherance of some scheme to promote the pecuniary interest of the actors, and to the detriment of the corporation, giving indication of a breach of trust on the part of the authorities in charge and control of the corporate affairs. But no such facts are presented here."

⁷⁶ *Id.* at 111.

TEXAS

In *Green v. Bennett*,⁷⁷ the majority holders voted to dissolve a national bank under a United States statute. A minority holder's suit to enjoin the dissolution was dismissed on demurrer, the court stating:⁷⁸

"Lying at the root of appellants' case is the question of the right of the owners of two-thirds of the shares of a National Bank, which is in a solvent and prosperous condition, to put it into liquidation, for the purpose of terminating its existence, to the detriment of the interests of minority stockholders not consenting to such liquidation.

"The only injurious consequence, claimed by appellants to have resulted to themselves from the dissolution, is the destruction of so much of the value of their stock as is derived from the value of the good will of the business. That this effect will follow is clear. By the dissolution appellants exchange their shares in a prosperous, dividend-paying business for a claim in liquidation to a proportionate share in the surplus assets, but this follows, as a necessary consequence, in all cases of a dissolution of a solvent, dividend-paying bank, whose shares have a value, on account of this fact, above their book value, based upon its capital, surplus, and undivided profits, and cannot be avoided without denying the right to liquidate a bank in a prosperous condition, and we think this cannot be done. Once in liquidation what appellants term the 'good will' of the bank, no matter how valuable before the dissolution, becomes a negligible quantity. The act of liquidation destroys the value of such good will, as a value separate and apart from the value of the tangible assets. *Centralia National Bank v. Marshall*, 26 Ill. App. 440; *Watkins v. National Bank*, *supra*. In this loss in the value of their stock all proportionately share.

"Summing up the material allegations of the petition, they show no more than, first, that appellees refuse to continue the business of the First National Bank, though such business is prosperous and profitable to themselves, as well as to appellants, but choose rather to terminate the business by liquidation under the statute, and thus destroy so much of the value of appellants' stock as rests upon the good will of the business of the bank as a continuing business; and, second, that they deny to appellants the right to share in the stock of the Yoakum National Bank. In neither case do we think that their rights have been violated. If, in winding up the business in liquidation, appellants, by mismanagement, fraud, or otherwise on the part of appellees, or the persons composing the liquidating committee, are deprived of any part of the full amount to which they are entitled as the value of their stock in liquidation, they have their remedy against the persons so offending in a suit against them for such damages. We are of the opinion that the petition shows no cause of action, and that the general demurrer was properly sustained."

⁷⁷ 110 S. W. 108 (Ct. Civ. App., Tex., 1908).

⁷⁸ *Id.* at 115 and 117.

WASHINGTON

In *Theis v. Spokane Falls Gaslight Co.*,⁷⁹ the majority holders dissolved a corporation. The court granted an injunction to minority holders, stating:⁸⁰

"A circumstantial review of the testimony in this case would not be profitable, but, from an examination of all the testimony, we are convinced beyond a doubt that the object of the attempt to dissolve the corporation was for the purpose of getting rid of uncongenial minority stockholders. * * * the record here shows conclusively that no real cause for dissolution existed; that the corporation was making money and prospering in every way; and, while this would probably not be a sufficient reason why a court should not grant the dissolution, it bears upon the question of whether or not there was an actual intent to disincorporate. But it is plainly stated that the object was to get rid of a disagreeable stockholder who would not sell his stock, Anderson testifying that the Spokane Gas Company was formed for the purpose of taking over the gas plant. It is apparent that, if the respondents could have purchased appellant's stock, the disincorporation would not have been thought of. The practice is one which is frequently indulged in for the purpose of what is described in vulgar phrase as 'freezing out' small stockholders; a compliance with the letter instead of the spirit of the statute; a pernicious practice, which courts of equity cannot too promptly condemn."

In *Beutelspacher v. Spokane Savings Bank*,⁸¹ the majority stockholders dissolved a corporation and turned its assets over to a new corporation in order to avoid a state taxing statute. A minority stockholder brought suit to have the transfer of the assets to the new corporation declared illegal and void. The court dismissed the action, stating:⁸²

"This case differs from that of *Theis v. Spokane Falls Gas Light Co.*, 34 Wash. 23, 74 P. 1004, where it was held that an attempted dissolution of a prosperous corporation and the transfer of its assets to a new corporation, for the sole purpose of getting rid of a disagreeable stockholder who refused to sell his stock, could not be sustained. In this case the evidence shows clearly that the officers and directors of the Spokane Savings & Loan Society, in taking the action that they did with reference to the society and with reference to the bank, were actuated by an honest and sincere desire to promote the interests of the shareholders of the society. The trial court, in a memorandum opinion filed after the trial, said: 'I am convinced from the evidence that the officers and directors of the Spokane Savings & Loan Society, in taking the action that they did with reference to said Society and with reference to the Spokane Savings Bank, were actuated by an earnest desire and sincere

⁷⁹ 74 Pac. 1004 (Wash., 1904).

⁸⁰ *Id.* at 1005 and 1006.

⁸¹ 2 P. (2d) 729 (Wash., 1931).

⁸² *Id.* at 730 and 731.

motive to advance and promote the best interests of the shareholders of the savings and loan institution. * * *”

“Where the statute gives authority to dissolve a corporation, and the requisite number of shareholders supports the resolution for dissolution and liquidation, the courts will not examine into the affairs of the corporation for the purpose of determining whether the action was expedient or wise.”

CONCLUSION

The leading cases reviewed above indicate that the courts will permit majority stockholders to dissolve a profitable corporation according to statute and that minority holders can prevent dissolution only in cases where there is (1) fraud⁸³ or (2) a “freezing out” of minority holders with the purpose of continuing the business for the benefit of the majority holders,⁸⁴ or (3) where the dissolution is, in actual effect a consolidation of two or more corporations contrary to law,⁸⁵ or (4) a sale of assets to the majority holders for an inadequate price.⁸⁶

⁸³ See *Kavanaugh v. Kavanaugh Knitting Co.*, note 65 *supra*; *Welt v. The Beachcomber, Inc.*, note 73 *supra*.

⁸⁴ See *Lebold v. Inland Steamship Co.*, note 27 *supra*; *Kavanaugh v. Kavanaugh Knitting Co.*, note 65 *supra*; *Major v. American Malt & Grain Co.*, note 67 *supra*; *Welt v. The Beachcomber, Inc.*, note 73 *supra*; *Theis v. Spokane Falls Gaslight Co.*, note 79 *supra*.

⁸⁵ See *In Re Doe Run Lead Co.*, note 38 *supra*; *William B. Ricker & Son Co. v. United Drug Co.*, note 50 *supra*; *Ervin v. Oregon Ry. & Nav. Co.*, note 56 *supra*.

⁸⁶ See *Allied Chemical & Dye Corporation v. Steel & Tube Co. of America*, note 23 *supra*; *Major v. American Malt & Grain Co.*, note 67 *supra*; *In re American Telegraph & Cable Co.*, note 71 *supra*.

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