Michigan Law Review

Volume 56 | Issue 6

1958

Corporations - Dissolution - Equity Power to Dissolve Going Concern for Dissension

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CORPORATIONS—DISSOLUTION—EQUITY POWER TO DISSOLVE GOING CONCERN FOR DISSENSION—The stock in a hotel management corporation was divided equally between two families, each of which had for some years been unable to agree or cooperate with the other in the management of the business. As a result of this dissension, no meeting of stockholders or directors was held for some years, no withdrawals of profits had been possible for six years, and the corporation had been operated at a loss for the year prior to suit. While the concern was not insolvent, such a financial state was allegedly imminent, the business of the corporation was admittedly poorly managed and its property was in need of repair. In view of these facts the owners of one half the stock brought an action for dissolution of the corporation in equity. From an order granting dissolution and dismissing a cross-bill for specific performance of an

option to buy plaintiff's stock, defendants appealed. *Held,* affirmed.[1] Neither a showing of insolvency nor statutory authorization is necessary for equity to act when dissension is accompanied by "financial loss, corporate paralysis, mismanagement and deterioration of property." *Levant v. Kowal,* 350 Mich. 232, 86 N.W. (2d) 336 (1957).

It is still the tendency for courts to speak, as did the court in the principal case,[2] of a general rule that equity, absent statute, has no power to dissolve or wind up[3] the affairs of a solvent going corporation at the suit of a stockholder. This doctrine, which has its basis in the notion that only the legislature could traditionally determine life or death for the corporation,[4] has in the past century been so engrafted with exceptions and limitations that its validity may be doubted today.[5] Michigan is one of the few large commercial states in which legislation has not been enacted to grant equity courts statutory dissolution power in cases of deadlock.[6] The state was also one of the first, however, to recognize the inherent ability of equity, in "exceptional" circumstances, to dissolve corporations.[7] The significance of the principal case, then, is found not so much in its assumption of the dissolution power as in its declaration of the ground upon which it recognizes equity dissolution as proper. While fraud, gross mismanagement, non-user, and failure of corporate purpose have frequently

[1] The court's affirmance also went to the issue presented by defendant's cross-bill concerning the existence of a "first option" restriction upon plaintiff's power to transfer shares. Defendants' claim that the request for dissolution brought the option into operation was rejected by the court on the ground that the option agreement contemplated only a transfer of capital stock. The court held that plaintiff's request was one for sale of assets, not capital stock. This holding accords with the generally accepted principle that such options are to be narrowly construed. Dobry v. Dobry, (Okla. 1953) 262 P. (2d) 691. See generally O'Neal, "Restrictions on Transfer of Stock in Closely Held Corporations: Planning and Drafting," 65 HARV. L. REV. 773 (1952). It is submitted, however, that an option drafted to cover this eventuality and containing a fair valuation formula might produce the most desirable result, enabling the party desiring to terminate his investment to do so and obtain a fair return while allowing the other party, if he desires, to continue the business without interruption.

[2] Principal case at 242.

[3] A distinction is frequently drawn by courts between dissolution and winding up. Dissolution is generally thought to go beyond the mere disposition of assets, which constitutes a winding up, and includes a termination of the corporate franchise. See, e.g., Schneider v. Schneider, 347 Mo. 102 at 109, 146 S.W. (2d) 584 (1941).

[4] Corporations were originally created by special legislative charter and it was thus reasonable to hold that since the state "gave," only the state could "take away." Today the almost exclusive use of general incorporation statutes has rendered such reasoning less tenable. See Goodwin v. Von Cotzhausen, 171 Wis. 351, 177 N.W. 618 (1920).

[5] That the equity courts have inherent power to dissolve is the majority rule, see Hornstein, "A Remedy for Corporate Abuse," 40 COL. L. REV. 220 (1940). But see COOK, CORPORATIONS, 8th ed., §629 (1923); 16 FLETCHER, CYC. CORP. §§8080, 8098 (1942) to the contrary.

[6] For examples of the broad statutory authority granted the courts in cases of intracorporate dissension and deadlock, see, e.g., 22 N.Y. Consol. Laws (McKinney, 1943; Supp. 1957) §103; Ohio Rev. Code (Page, 1954; Supp. 1957) §1701.91.

[7] Miner v. Belle Isle Ice Co., 93 Mich. 97, 53 N.W. 218 (1892).

been successfully invoked as bases for equity dissolution,[8] intracorporate dissension apart from statute has never appeared as either the sole or principal[9] justification for decision. This is so perhaps because dissension in the large publicly-held corporation seldom prevents the successful conduct of corporate affairs by the board of directors. Deadlocks are rare, and the dissenting minority has the alternative of buying sufficient shares to gain control, or of selling out. In such a setting, the potential adverse effects of dissension are minimal, and it is recognized that mere differences of opinion do not constitute grounds for dissolution.[10] However, in the case of the closely held "family" corporation, where the stock is evenly divided, dissension frequently means ruinous deadlock. The remedies of the dissenter to buy further or sell out are not so easily accomplished. Thus as in the case of a partnership, to which some writers have analogized this situation,[11] equity dissolution may become a useful and desirable judicial tool if wielded with care. When a deadlock occurs it would normally seem to be in the interest of the stockholders, the creditors and the state to dissolve the corporation for, as indicated in the principal case,[12] in this area dissension rarely exists alone. It is most often accompanied by fraudulent exclusion, corporate paralysis, mismanagement, or substantial deterioration of property. While thus reiterating that dissension alone is not a sufficient allegation for dissolution the court perhaps establishes a "dissension, plus . . ." test for Michigan.[13] The imprecise nature of such a test is not to be criticized. Equity dissolution should not be made a weapon of power for the whimsical dissenter, nor should it be invoked and applied inflexibly, since the factual variations that may accompany dissension are many. It would seem these cases are best decided empirically, since dissolution may often work serious detriment to one faction, rather than merely terminating the existence of an entity doomed to eventual failure.

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8 See cases cited in 16 FLETCHER, CYC. CORP. §§8081 et seq. (1942).

9 Cases in which equity power was used to dissolve a corporation on the ground of dissension and deadlock are collected in 13 A.L.R. (2d) 1260 at 1263 (1950). In none of these cases did it appear that dissension was the sole basis for dissolution; rather the dissension in each was accompanied by deadlock, mismanagement, exclusion of the opposing group, or financial reverses.

10 See 16 FLETCHER, CYC. CORP. §§7712, 8082 (1942).

11 See, e.g., 47 MICH. L. REV. 684 (1949). See generally, Israels, "Sacred Cow of Corporate Existence: Problems of Deadlock and Dissolution," 19 UNIV. CHI. L. REV. 778 (1952).

12 Principal case at 244.

13 Such a test seems equally valid as a summarization of the decisions in other jurisdictions on the same subject. See note 8 supra. It is also consistent with the more general observation that while one detrimental factor standing alone will be considered insufficient grounds for equity dissolution, a combination of factors will satisfy the court that dissolution is warranted. See In re Brinsmead & Sons, [1897] 1 Ch. 45.