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CORPORATIONS-SALE OF ALL OR SUBSTANTIALLY ALL OF CORPORATE ASSETS-EFFECT OF MODERN STATUTES

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COMMENTS

CORPORATIONS—SALE OF ALL OR SUBSTANTIALLY ALL OF CORPORATE ASSETS—EFFECT OF MODERN STATUTES—Modern general corporation acts commonly provide that a sale of all or substantially all of the assets of a corporation organized thereunder may be authorized by the affirmative vote of a specified proportion of the outstanding shares and made upon such terms as the board of directors shall deem expedient and for the best interests of the corporation.[1] Since this sale

[1] A large number of these statutes are patterned after the Delaware provision enacted in 1917 by 29 Del. Laws, c. 113, § 17 and now embodied in Del. Rev. Code (1935) § 2097, which requires only the approval of a majority of the shares and of which the text in the body of this comment is a paraphrase. See, for example, Cal. Civ.

provision usually stands apart from the dissolution or winding-up process authorized in the same acts,[2] a legislative intent to govern all voluntary sales, not actually incident to dissolution by the terms of the statute would seem to be clear. Yet the argument has been made that, under certain circumstances, a sale of all or substantially all of the corporate assets is within the competence of the directors. A recent Michigan case, *Michigan Wolverine Student Co-Operative, Inc. v. Wm. Goodyear and Co.*,[3] affords an excellent opportunity to examine the argument and, it is hoped, indicate its lack of validity. Since it is not proposed to discuss what constitutes a sale of substantially all assets, the treatment will be phrased in terms of the simple-sale-of-all-assets case.

A. *The Principal Case*

In the *Michigan Wolverine* case, plaintiff was a corporation organized under the Michigan General Corporation Act[4] for the purpose of promoting student welfare at the University of Michigan.[5] Faced with

Code (Deering, 1941) § 343; Fla. Stat. Ann. (1941) § 612.35; Mich. Stat. Ann. (1937) § 21.75; Minn. Stat. (Mason, 1927) § 7447-1. The Ohio statute, Ohio Gen. Code (Page, 1938) § 8623-65, adopts the Delaware provision but exempts from its application sales which do not substantially limit the corporate business or the proceeds of which are appropriated to the development of the remaining corporate business.

Other statutes adopt various phrasings but are of the same general effect. Variations in the proportion of assenting shares required are found in the following statutes: Ala. Code Ann. (1940) tit. 10, § 91 (four-fifths); Conn. Gen. Stat. (1930) § 3384 (two-thirds); Ill. Ann. Stat. (Smith-Hurd, 1934) c. 32, § 157.72 (two-thirds); Ind. Stat. Ann. (Burns, 1933) § 25-239 (two-thirds); Ky. Rev. Stat. (1944) § 271.320 (three-fourths); N.Y. Stock Corp. Law (McKinney, 1940) § 20 (two-thirds). Limitations as to the application of the statutes are found in the following: Ala. Code (1940) tit. 10, § 91 (sale of entire property only); Ky. Rev. Stat. (1944) § 271.320 (sale of all assets); Me. Rev. Stat. (1944) c. 49, § 80 (sale of assets essential to continuation of business); Pa. Stat. Ann. (Purdon, 1936) tit. 15, § 2852-311 (sale not in the usual or regular course of business).

See, generally, 6 FLETCHER, CYCLOPEDIA CORPORATIONS, perm. ed., § 2949 (1931); 13 ibid., § 5798 (1943).

[2] The following are illustrative: Del. Rev. Code (1935) §§ 2071, 2077; Ky. Rev. Stat. (1944) §§ 271.300, 271.350, 271.360; Mich. Stat. Ann. (1937) § 21.65 et seq.; N.Y. Stock Corp. Law (McKinney, 1940) §§ 95, 105; Ohio Gen. Code (Page, 1938) §§ 8623-67, 8623-79.

And see, Warren, "Voluntary Transfers of Corporate Undertakings," 30 HARV. L. REV. 335 at 346-348 (1917).

[3] 314 Mich. 590, 22 N.W. (2d) 884 (1946).

[4] Mich. Stat. Ann. (1937) c. 195.

[5] Michigan permits organization of non-profit co-operative corporations under the General Corporation Act. Mich. Stat. Ann. (1937) § 21.118. Consequently, the plaintiff's non-profit character played no part in the litigation and it is not proposed to discuss that aspect of the problem herein. For an interesting discussion of the sale of the assets of non-profit corporations, see 23 IOWA L. REV. 656 (1938).

declining revenues as a result of the decline in civilian student enrollment during the war years, the board of directors authorized the sale of the principal corporate asset, real estate in which plaintiff had operated a restaurant, and the officers executed a warranty deed to the defendant. Later, the acts of the directors and officers never having been ratified by a majority of the membership, as required by the Michigan statute,[6] plaintiff filed a bill to set aside the deed.

In the lower court, defendant successfully engrafted a so-called common law exception on the statute to the effect that the directors of a corporation in financial distress or in a failing condition might authorize a sale of all the corporate assets without seeking shareholders' approval.

The Michigan Supreme Court, in holding that the statute governed the sale regardless of the financial condition of the corporation stated:

"... The statute does not authorize the board of directors of a corporation to sell all or substantially all of the corporate assets whenever, in the opinion of the directors, the corporation is not a going and prosperous concern, or is in a failing condition. If a corporation is no longer a going concern the statute provided several methods whereby the corporation may wind up its affairs, dispose of the assets, and cease to exist. None of these methods authorizes a board of directors to dispose of the assets without action by the stockholders, or by a court."[7]

B. *The Common Law*

The validity of this interpretation of the statute can best be examined by looking first to the common law governing the sale of all assets of a corporation.

1. *As to prosperous and going concerns.* In the absence of statute, the United States Supreme Court and the vast majority of state courts subscribed to the rule that only the shareholders, acting unanimously, had the power to authorize a sale of all assets.[8] The rationale for this

[6] Mich. Stat. Ann. (1937) § 21.57.

[7] 314 Mich. 590 at 600, 22 N.W. (2d) 884 (1946). The decision goes on to a determination that, assuming arguendo that there is room in the statute for an exception applicable to corporations in financial distress, plaintiff was not in such a financial plight as to warrant invoking the exception. Since, under the view taken by the Michigan court and supported herein, the financial condition of a corporation is not pertinent to modern statutes regulating the sale of assets, this aspect of the case will not be considered.

[8] The leading case is generally conceded to be Abbot v. American Hard Rubber Co., 33 Barb. (N.Y.) 578 (1861). Other cases commonly cited include Geddes v. Anaconda Copper Mining Co., 254 U.S. 590, 41 S. Ct. 209 (1921); Butler v. New Keystone Copper Co., 10 Del. Ch. 371, 93 A. 380 (1915); People v. Ballard, 134 N.Y. 269, 32 N.E. 541 (1892); Kean v. Johnson, 9 N.J. Eq. 401 (1853). Michigan law is reflected in Voigt v. Remick, 260 Mich. 198, 244 N.W. 446 (1932). See,

position was found in the implied contract between the shareholders that the corporation was to continue in operation for the charter period, or, at least, for so long as the corporation proved profitable and capable of carrying on its purpose.[9] The rule may be subjected to criticism on a variety of grounds: that it was incompatible with the common law doctrine that a bare majority of the shares could accept a repeal of a special charter,[10] that the sale was presumably advantageous and a profitable transfer was clearly within the majority's power in directing the business,[11] or, more simply and perhaps more pointedly, that it gave a single dissenting shareholder a stranglehold on the majority which could be used effectively to demand a purchase of the minority shares at an exorbitant price.[12] These objections were reflected in a scattering of cases which ruled that a sale of all the assets of a going and prosperous concern was within the power of the majority of the shares.[13]

2. *As to concerns in failing circumstances.* The arguments advanced against the accepted doctrine as to the sale of all assets of a going and prosperous concern assumed new force as applied to corporations in a financially precarious condition. In particular, it was difficult to argue that the liquidation of assets was inconsistent with corporate purposes when the prospects of achieving those purposes were dimming. Further, the stranglehold of the dissenting shareholder obviously became more painful as the corporation approached insolvency. The courts responded to these arguments with the rule that a majority

generally, BALLANTINE, CORPORATIONS, § 59 (1927); 3 COOKE, CORPORATIONS, § 670 (1923); 6 FLETCHER, CYCLOPEDIA CORPORATIONS, perm. ed., §§ 2942 and 2947 (1931).

[9] Geddes v. Anaconda Mining Co., 254 U.S. 590, 41 S. Ct. 209 (1921); Voigt v. Remick, 260 Mich. 198, 244 N.W. 446 (1932); Hanrahan v. Andersen, 108 Mont. 218, 70 P. (2d) 494 (1939); Kean v. Johnson, 9 N.J. Eq. 401 (1853). Of course, in the absence of statute, it is open to the corporation to provide in the articles of incorporation that a sale may be made by a fraction of the shares or even by the directors acting alone. City of St. Louis v. St. Louis Gaslight Co., 70 Mo. 69 (1879). Similarly, sale by the directors is impliedly authorized by the articles when the stated purpose is to buy and sell property. 6 FLETCHER, CYCLOPEDIA CORPORATIONS, perm. ed., § 2948 (1937).

[10] Warren, "Voluntary Transfers of Corporate Undertaking," 30 HARV. L. REV. 335 (1917).

[11] Power of majority stockholders to authorize the sale of all the corporate property, 14 MINN. L. REV. 58 (1929), and Rights of minority stockholders in consolidations and in sales of entire corporate assets, 19 VA. L. REV. 166 (1932). See, especially, In re Timmis, 200 N.Y. 177, 93 N.E. 522 (1910).

[12] BALLANTINE, CORPORATIONS 210 (1927).

[13] Treadwell v. Salisbury Mfg. Co., 7 Gray (73 Mass.) 393 (1856); Bowditch v. Jackson Co., 76 N.H. 351, 82 A. 1014 (1912); Beidenkopf v. Des Moines Life Insurance Co., 160 Iowa 629, 142 N.W. 434 (1913); Paterson v. Shattuck Arizona Copper Co., 186 Minn. 611, 244 N.W. 281 (1932); Cohen v. Bigstone Gap Iron Co., 111 Va. 468, 69 S.E. 359 (1910).

of the shares could authorize the sale of all assets of a corporation in financial difficulties.[14]

However, a number of statements by text writers and commentators can be found to the effect that the directors, acting without shareholder authorization or ratification, possessed the power to consummate a valid sale.[15] Since such a rule would relax the common law beyond the requirements of the legislative enactments with which we are concerned, it is important that we pause to examine a few of the cases which are said to support it.

Oskaloosa Savings Bank v. Mahaska County State Bank,[16] cited by Fletcher and *American Jurisprudence*,[17] refers approvingly to the proposition that the directors have such a power but the case is one in which the record affirmatively shows that the directors owned a majority of the shares.

State v. Western Irrigating Canal Co.[18] cited by Ballantine and Thompson,[19] decides only that the corporation had the power to sell all its assets as against the objection of the state and does not purport to decide what corporate action was necessary to effect a valid sale. The court specifically states, at page 100: "If the corporation could convey a part [of its assets], it could convey all, if its stockholders assented. . . ."

Howard v. Republic Bank & Trust Co.[20] appears to adopt the view stated by the commentators but the court goes on to say that the action of the board is not subject to attack by minority shareholders. Does not this imply that the majority shareholders could object to the directors' action?

Homan v. Fir Products Co.[21] decides, without enunciating any general rule, that a sale by the directors of the assets of an insolvent corporation was not void. However, it affirmatively appears that they owned a majority of the shares.

[14] Geddes v. Anaconda Mining Co., 254 U.S. 590, 41 S. Ct. 209 (1921); George v. Wallace, (C.C.A. 8th, 1904) 135 F. 286; Price v. Holcomb, 89 Iowa 123, 56 N.W. 407 (1893); Butler v. New Keystone Copper Co., 10 Del. Ch. 371, 93 A. 380 (1915); Cardiff v. Johnson, 126 Wash. 454, 218 P. 269, 222 P. 902 (1923).

[15] BALLANTINE, CORPORATIONS, § 59, note 68 (1927); 2 FLETCHER, CYCLOPEDIA CORPORATIONS, perm. ed., § 546 (1931); 4 THOMPSON, CORPORATIONS, 3d ed., §§ 2498 and 2509 (1927); 13 AM. JUR., Corporations, § 963.

[16] 205 Iowa 1351, 219 N.W. 530 (1928). A later Iowa case, Graeser v. Phoenix Finance Company, 218 Iowa 1112, 254 N.W. 859 (1934), adopts the majority of the shares requirement without mention of the Oskaloosa case.

[17] Supra, note 15.

[18] 40 Kan. 96, 19 P. 349 (1888).

[19] Supra, note 15.

[20] (Tex. Civ. App. 1934) 76 S.W. (2d) 187.

[21] 123 Wash. 260, 212 P. 240 (1923).

Treadwell v. Salisbury Manufacturing Co.,[22] cited by Ballantine as the leading case on this point,[23] stands for no more than that the majority of the shareholders might authorize a sale of all assets under certain circumstances.

Space does not permit the examination of all the cases cited on this point by various commentators but it is submitted that similar weaknesses exist in almost all of them. Nevertheless, the statement that the directors possess the power to dispose of all assets when a corporation is in financial distress has made a sufficient impression on our legal learning to be worthy of further consideration in connection with the modern statutes.

C. *The Application of the Statutes*

Turning to the statutes, which, as we have seen, provide that a specified proportion of the outstanding shares may authorize a sale of all assets, it is apparent that the question whether the statutes cover all such voluntary sales, except those made under the statutory dissolution or winding-up process, will be posed in three situations: (1) Where the statute requires authorization by a proportion larger than a bare majority of the shares and it is argued that the common law permits authorization by a bare majority; (2) Where the statute requires authorization by a proportion larger than a bare majority of the shares and it is argued that the common law permits authorization by a bare majority when the corporation is in financial distress; (3) Where the statute requires authorization by a specific proportion of the shares and it is argued that the common law permits a sale of all assets by the directors without authorization by the shares when the corporation is in financial distress. With reference to the first of these, the statute is co-extensive with the common law rule advanced, neither one recognizing the financial condition of the corporation as of any significance; hence, it is clear that the statute supersedes the common law rule in its entirety. However, with reference to the second and third situations, the argument may be advanced, as in the principal case, that the statute is intended only to temper the common law requirement of unanimous consent of the shares when the corporation is a prosperous and going concern, and that it has no bearing on the more liberal holdings regarding corporation in financial distress or in a failing condition.

This argument must be rejected both on principle and authority. First, it must be recognized, in so far as the third situation is concerned, that the common law rule contended for is predicated on extremely

[22] 7 Gray (73 Mass.) 393 (1856).

[23] Supra, note 15.

doubtful authority. Second, a contrary interpretation is indicated in both situations by familiar principles of statutory construction. The statutory declaration of a particular method for the exercise of a particular power, viz., the sale of all assets, precludes the valid exercise of the power by any other method.[24] It is apparent that the legislative intent was at least to modify the common law requirement of unanimous consent of the shares to a sale of all assets of a prosperous and going concern,[25] but it seems equally clear that an intent to restrict the application of the statute to that particular situation would have been specifically expressed.[26]

In the words of the Iowa Supreme Court:

> "At common law it is the rule that neither the board of directors nor any number of stockholders can dispose of all the assets of a corporation which is conducting a prosperous business, against the dissent of even a single stockholder. Where, however, a corporation is insolvent or its business is being conducted at a loss, a majority of the stockholders may, in the absence of fraud, compel a sale of all its assets, even though a minority of the stockholders is opposed to such disposition. . . . In many states, however, statutes have been enacted which supersede the common-law rule and authorize the disposition of all the assets of a corporation by a majority or a certain percentage of the stockholders, regardless of whether the coporation is in a prosperous condition or not."[27]

The case law under the statutes favors this conclusion.[28] Indeed,

[24] CRAWFORD, CONSTRUCTION OF STATUTES, § 195 (1940). While this principle undoubtedly should be applied cautiously, it is apt, where, as here, the text of the statute is phrased in the most general terms. Cases applying the principle to statutes using permissive language include: Botany Worsted Mills v. United States, 278 U.S. 282, 49 S. Ct. 129 (1929); Dietrich v. Jones, 227 Mo. App. 365, 53 S.W. (2d) 1059 (1932); Taylor v. Taylor, 66 W. Va. 238, 66 S.E. 690 (1909).

[25] Hanrahan v. Andersen, 108 Mont. 218, 70 P. (2d) 494 (1939); Wattley v. National Drug Stores Co., 122 Misc. 533, 204 N.Y. S. 254 (1924). See, also, BALLANTINE, CORPORATIONS 210 (1927).

[26] Commerce Trust Co. v. Chandler, (C.C.A. 1st, 1924) 295 F. 241; In re Timmis, 200 N.Y. 177, 93 N.E. 522 (1910). Specific provision for solvent and insolvent corporations, sale by two-thirds vote of the shares being authorized for the former and sale by two-thirds vote of the directors for the latter, is made in La. Gen. Stat. (Dart, 1939) § 1121.

[27] Graeser v. Phoenix Finance Co., 218 Iowa 1112 at 1121, 254 N.W. 859 (1939).

[28] Starrett Corp. v. Fifth Ave. & Twenty-Ninth St. Corp., (D.C.N.Y. 1933) 1 F. Supp. 868; Robinson v. Pittsburgh Oil Refining Co., 14 Del. Ch. 193, 126 A. 46 (1924); Shell v. Conrad, (Mo. App. 1941) 153 S.W. (2d) 384; Kaszubowski v. Buffalo Telegram Corp., 131 Misc. 563, 227 N.Y. S. 435 (1928); In re Timmis, 200

the only contrary statement of the law is found in one of the legal encyclopedias, which states, "Such statutes do not, however, prevent a sale without a vote if the corporation is insolvent or in failing circumstances and the sale is made for the purpose of closing up corporate affairs."[29] It may immediately be observed that if these statutes do not govern a sale made for the purpose of winding up corporate affairs, it is only because other statutes do.[30] Beyond this criticism, however, is the fact that neither of the cases cited therein squarely decide this question.[31] Thus, it may fairly be concluded that the statutes are intended to supplant the much litigated common law rules with one simple and uniform principle; the majority (or some other fraction) of the outstanding shares may authorize a sale of all or substantially all of the corporate assets regardless of the corporation's financial condition.[32] As indicated by the principal case, failure to comply with this statutory procedure will invalidate the sale.

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N.Y. 177, 93 N.E. 522 (1910); Cyclone Drill Co. v. Zeigler, 99 Ohio St. 151, 124 N.E. 131 (1918).

[29] 18 C. J. S., Corporations, § 515 at p. 1197.

[30] Butler v. New Keystone Copper Co., 10 Del. Ch. 371, 93 A. 380 (1915); American Pacific Whaling Co. v. Commissioner, (C.C.A. 9th, 1935) 74 F. (2d) 613.

[31] The two cases, Bassett v. City Bank & Trust Co., 116 Conn. 617, 198 A. 557 (1933), and Mills v. Tiffanys, Inc., 123 Conn. 631, 198 A. 185 (1938), contain sweeping statements that the Connecticut statute does not apply to the sale of all assets by a corporation which is in financial distress but the statements are pure dicta.

The Bassett case, supra, involved a bank, which is expressly excluded from the Connecticut statute. The issue was whether a bank, being so excluded, was impliedly forbidden to sell its assets at all. Furthermore, the report shows that the transfer actually had been ratified by the shareholders, the complaining party being a creditor.

The Mills case, supra, cites the Bassett case approvingly but limits it to sales made for the purpose of winding up corporate affairs. However, the issue was whether a minority stockholder was entitled to notice of reorganization proceedings under the Federal Bankruptcy Act.

[32] This conclusion leaves open the question of the applicability of the statutes to corporations which are organized for the purpose of trading in property. Some statutes specifically except such corporations. See, for example, Pa. Stat. Ann. (Purdon, 1936) tit. 15, § 2852-311; Wis. Stat. (1945) § 180.11. An implied exception as to such corporations would seem to arise from the statute itself, where no specific exception is made, since the necessity of securing shareholder approval of sales would practically frustrate the accomplishment of an unauthorized purpose. See, on this problem, Wattley v. National Drug Stores Co., 122 Misc. 533, 204 N.Y.S. 254 (1924); Thayer v. Valley Bank, 35 Ariz. 238, 276 P. 526 (1929); Gottschalk v. Avalon Realty Co., 249 Wis. 78, 23 N.W. (2d) 606 (1946).