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## The Stockholder's Remedy of Corporate Dissolution

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## BOOK REVIEW

**The Stockholder's Remedy of Corporate Dissolution.** JAMES O'MALLEY TINGLE. Missoula, Montana: Montana State University Press, 1959. Pp. 238. \$12.00.

With several favorable reviews to its credit already, the latest addition to the MSU Studies in Law Series of publications, entitled, *The Stockholder's Remedy of Corporate Dissolution*, should be of special interest both to the graduates of the Montana State University Law School, and to practitioners generally, over the State. Formerly of Montana, its author, James O. Tingle, also is a three times graduate of the University, each with honors, having received his LL.B. from Montana in 1952. Moreover, he was a member of Montana's law faculty for a brief period, before joining the legal department of the Shell Oil Company, where he is at present. So, many Montana law school alumni will be interested in this book because of their personal acquaintance with the author, and because it well fulfills Tingle's early promise of scholarship; the practitioner will be particularly interested in this study when he learns that it is a very "practical" book in the strict "bread and butter" sense.

While still an undergraduate, Mr. Tingle first became interested in the general question of how far the law of corporations relating to the supervision of management functions might be improved by a wider and more dynamic use by the courts of the traditional "visitatorial powers" of equity. In his doctoral dissertation, that interest was expressed in the definitive form contained in the present study. The particular problems of majority oppression, and management deadlock, often arising in corporate operations which are the subjects of Tingle's study, raise special questions in the general area of corporation law involving the rights and duties of stockholders *inter sese*. The general problems for which Tingle proposes the particular solution of "involuntary corporate dissolution," may be expressed in the following broadly stated question: "What remedies, if any, are available for the injured stockholders in a case either of freeze-out, or of deadlock?"

Traditional doctrines of corporation law lead easily to the conclusion that dissolution of a corporation is possible only for those reasons and under the circumstances authorized by statute—even though in cases of oppression or deadlock no other remedy is adequate or satisfactory. Traditionally also, corporation codes have not authorized dissolution on the petition of a minority stockholder. Forced to search for respectable common law principles supporting such dissolution, "in appropriate cases," Tingle finds adequate support therefor—even if only after considerable modification of traditional doctrine—on two grounds: 1. The court of equity's visitatorial powers over corporations, of ancient origin; 2. The long unquestioned power of equity to dissolve partnerships, upon petition of any partner, for oppression or exclusion from management by the other partner or partners—*provided* the courts can be persuaded that the issues raised in the corporate situation are sufficiently similar to be governed by the same principles. Historically, of course, courts quite generally have ruled that the partnership analogy is not only *not* controlling; it is not even persuasive, because of the supposed fundamentally different principles regulating partnerships from those controlling corporations—this because the partner-

ship is based on private contract, while the corporation exercises a sovereign franchise expressing an overriding state interest.

Instead of developing their visitatorial powers in equity over corporations into a pervasive practice in modern times, American courts have come to utilize these powers less and less. Although remnants of it are found in the "stockholder's derivative suit," and in the very modern practice of "piercing the corporate veil" in certain cases, historically, the link between these practices and early-day powers of "visitation" is very weak. Moreover, the partnership analogy has not been helpful in the past. Until recently, the decisions relying on "partnership" analogies in corporation law have been rare indeed. Instead, under the influence of the idea that corporate charters grant special concessions from the state, courts have been inclined to interpret both constitutional and statutory law as being "exclusive and mandatory," with the state's interest in the continuation of the corporation such as to require that it be a party to any suit for dissolution, or at least that such proceeding be strictly according to general provisions contained in existing statutes. Further, in any proceeding claiming damage from action either by the board or by the corporation's officers, this rationale has caused the courts generally to consider only the interests of the corporation, *i.e.*, if the action complained of did not injure the corporation as such, no redress would lie. Indeed, much of the time in the earlier development of corporation law in the United States, the courts have been derelict in refusing to recognize the general fiduciary nature of the relationship between and among stockholders. All of this long made it difficult for a minority group of stockholders to establish appropriate and adequate remedies for the misdeeds of the majority which the majority intended to injure the minority. Thus, any prospective "ruin" which the plaintiff alleged had to be to the corporation, rather than to the individual stockholders.

Yet, at an early date, equity had exercised a limited jurisdiction to dissolve corporations on the petition of individuals but only upon a sufficient showing of *corporate* injury. As illustration, Tingle cites the rule allowing liquidation and dissolution of an insolvent corporation upon the petition of simple creditors, and that permitting dissolution of "moribund corporations." But it remained for the fact situation of a Michigan case in 1892,<sup>1</sup> to dramatize the stark *necessity* of providing the remedy of dissolution for the protection of minority stockholders in certain situations. It presented a case of the grossest kind of "oppression" of one stockholder by another who was the controlling stockholder and an officer, and who had the evident intention of freezing out the former. Once the court accepted the principle that the duty to act in good faith in managing corporate affairs for the *common* welfare of all stockholders runs reciprocally among all the stockholders, and thus runs from the majority in management control to the minority, the court was led irresistably in this case to recognize the validity of the partnership analogy as justifying liquidation and dissolution on the request of the oppressed petitioner as a means of permitting stockholders to protect directly all of their rights and privileges as stockholders. Of course, this conclusion was made much easier by the fact that it was a "close corporation" that was involved—only two principal stockholders with a

<sup>1</sup>Miner v. Belle Isle Co., 93 Mich. 97, 53 N.W. 218 (1892).

third nominal holder. Although Tingle finds that almost all direct authority at the time was opposed to this decision, with the fine analysis which it offers as a guide, modern authority overwhelmingly supports the Michigan court's conclusion that equity does have inherent power to dissolve corporations in cases of "oppression and freeze-out," although the conditions required to support that action may vary in different states, and courts generally still use the power sparingly.

The second problem, related to oppression, which interests Tingle is "deadlock," defined either as that condition resulting from an equally divided directorate, with one faction cancelling out the order—complete deadlock; or as that condition resulting from a division of stock such as to make impossible the election of a new board—incomplete deadlock. Since most cases of oppression and deadlock occur in the close corporation, often called "the incorporated partnership," Tingle maintains that the partnership analogy, based on the fact that each partner is equally entitled to a full share in the profits *and to equal participation in the management*, also should be the controlling criterion for deadlock cases. So, he next makes a carefully detailed comparative examination of those decisions to determine to what extent, if at all, the courts have used partnership law as a guide. At this point, Tingle sums up his findings and conclusions thus:<sup>5</sup>

It was never sound to say that equity lacked power to liquidate a corporation as a remedy for majority oppression. Nor is it soundly applied to deadlock. The idea steadily loses favor. Modern deadlock cases will show that the question of power is of decreasing significance.

He finds evidence of six different criteria or standards relied on by those courts recognizing a common law *power* to dissolve for deadlock, complete or incomplete, with few American courts utilizing the partnership analogy.

The examination which Tingle makes of statutory provisions that might be relied on for, or which expressly authorize dissolution for oppression or for deadlock, convinces him that the statutes have not done much to "liberalize" the law further in this area. In Tingle's words:<sup>6</sup>

these standards merely grant or, *in most instances, affirm* a power (to dissolve). The troublesome point is the application of that power. Common law diffidence will usually continue. In proportion as common law judges were mistaken, judges acting under these statutes are likely to be mistaken. They will remain relatively free, even in the face of proved incorrigibility, to apply traditional alternatives in lieu of liquidation. Without express legislation to the contrary there is little hope in many states that courts will require a better reason for this than that liquidation is a drastic, last resort. The problems are to make liquidation (1) more definite, and (2) less drastic to plaintiffs and perhaps more drastic to defendants.

Tingle proceeds to propose legislation adequate to serve these objectives. At the same time, he seeks both to discourage the "strike suit," on the one hand, and to limit dissolution, on the other, where the latter might in fact serve the interests of those trying to "squeeze out" the minority. He stresses the

<sup>5</sup>Page 81.

<sup>6</sup>Pages 176-77. (Italics supplied.)

importance of recognizing that the court should use its fullest equitable powers to tailor the precise remedies needed for the "most just result" in the particular case.

Just how "practical" this work may be for a Montana practitioner is dramatically illustrated by the experience of one attorney in a small firm in a small county seat in the state. About the time Tingle's study came off the press, this attorney had pending in his files three cases dealing with "majority oppression." This young lawyer assures the writer that Tingle's study directly and immediately enabled him to secure a highly satisfactory settlement for his client in the first case, and that it provided the basis for one of the two principal grounds on which the second one was settled. The third case may require litigation, but this attorney has good reason to be optimistic, on the basis of the apparent current law in other states, even though, as Tingle notes, the issues have not yet been adjudicated in Montana.

There is a surprisingly large amount of potential state litigation in this area, accentuated by the fact that so many Montana corporations are small family corporations in which "corporateness" is only nominal, and in which almost certainly those involved generally continue to operate essentially as a partnership—in short, the "incorporated partnership." These "corporate partnerships" are especially common in the ranching business, often a family operation, with all the stock held by different members of the family. Almost certainly such members of a family will expect to continue in just as full and complete participation in the operations as would partners. More than that, they probably will rely entirely on the "corporate business" for their entire livelihood, often including their lodging and keep. And of course, they expect continuous employment. So their stake is far more than just the chance to make a profit in the form of dividends from a side investment; hence, for them, a "squeeze-out" means tragedy. This is the personification of the "close corporation" which many students of corporations, supported by currently developing law, insist should receive the benefit of special rules taking these characteristics into account. The above mentioned attorney observes:<sup>4</sup>

If there exists no fraud or gross mismanagement in the corporation, Mr. Tingle's suggested remedy in corporate dissolution, because of oppression by the majority stockholders, is the only effective remedy left to a minority stockholder.

The Montana court should not have the slightest difficulty both in finding that it has the equity power to grant the remedy of dissolution for majority oppression, at least, and of fashioning a liberal rule for the reasonable exercise of that power. It readily can cite several different principles from its own decisions, justifying such practice. It long has approved resort to the "piercing the corporate veil" principle to prevent oppression and fraud, and, of course, it also frequently has recognized the derivative suit (although being unduly restrictive with this remedy at times)—both remnants of equity's visitatorial powers. More importantly, though, the Montana court should realize that the minority stockholder being squeezed out provides the classical opportunity for the court to consider exercising

<sup>4</sup>Personal correspondence, December 8, 1960.

its equity powers to "provide adequate and otherwise omitted remedies," as Tingle states it<sup>5</sup>—equity's historical function for insuring "justice." In other words, equity should "fulfill the law," to get a just result, and to forestall fraud and hardship. And, if so disposed, the court may base its jurisdiction to grant such relief on its "inherent powers" under the Constitution and statutes, as it has done on a few other occasions. If there should be any question in the court's mind as to how far it may reasonably go in the exercise of this common law power, for the present purpose a series of English cases interpreting their statute providing for the winding up of English corporations "whenever it is just and equitable that the company should be wound up," are authoritative on this point, because that clause is a simple declaration of the court's common law jurisdiction in equity. And the English court has not hesitated to treat the problem as being governed in substance by principles of partnership law, *i.e.*, the right of any partner to require dissolution.

If there should be any doubt remaining under the above suggestions as to what the result should be in Montana, on the ground that some Montana cases seem to interpret corporate statutes as mandatory and exclusive, it would appear that that doubt was eliminated by a recent Montana decision, which, on its face, seems to give the stockholders an unlimited power to vary the regulations of corporate statutes, as among themselves, by special stockholders' contracts. The *Polson Plywood* case<sup>6</sup> is a rejection of the "concession" theory of corporation law and of the doctrines relating thereto. Hence, while this case does not provide us directly with a rule on "involuntary dissolution," it makes available the partnership analogy by rejecting older doctrines which might have seemed to preclude that analogy in the corporate field. So it offers a formally articulated basis for giving effect to the currently developing ideas of many writers and some legislators, that the members of the small close corporation should be given more freedom in providing by contract for their respective rights and duties among themselves than might be tolerated in a public issue corporation. Even Judge Bottomly's strong dissent in the *Polson Plywood* case is not really opposed to this particular conclusion, because his dissent was predicated on what he felt was a special constitutional restriction, having an especially restrictive effect on the freedom of the corporation and the stockholders because of its particular language. So, even though our court should find it necessary later to limit its unqualified statements in the *Polson Plywood* case, concerning the freedom of the parties to change controlling corporation law by contract, the significance of that case in recognizing and authorizing "flexibility" in the shaping of rules regulating the internal management of a close corporation as among the stockholders, should not be affected. What the stockholders could do by contract, surely the court can do in appropriate cases. Finally, any court that can find the ancient common law remedy of *coram nobis* still surviving under Montana's Code of Criminal Procedure, should not have the slightest difficulty in providing for the oppressed minority stockholder the remedy of involuntary dissolution, wherever this remedy seems necessary "to get the most just result."

The practicality of this work goes beyond the bare question of dissolu-

<sup>5</sup>Page 38.

<sup>6</sup>*Sensabaugh v. Polson Plywood Company*, 135 Mont. 562, 342 P.2d 1064 (1959).

tion. For example, it puts into serious question the correctness of the majority opinion in *Noble v. Farmers Union Trading Co.*,<sup>7</sup> ruling that a determination of title to land cannot be made in a derivative suit. Tingle makes clear that the remedies provided therein may be fashioned to respond to all of the issues raised, both directly and collaterally or incidentally. So, if such title determination is necessary in a charge of excessive or fraudulent rental payments, the issue should be adjudicated as a matter of course.

A lawyer with any corporate practice, should seriously consider adding to his library this authoritative study of stockholders' remedies for oppression or deadlock.

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<sup>7</sup>123 Mont. 518, 216 P.2d 925 (1950).

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