Dissolution of the Close Corporation

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related to the original performance, that the effect should be treated as though there were a "performance" under the Act. "The economic realities demonstrate that the CATV system is in the business of selling television programs to the public." 71

The Court relied heavily on Buck v. Jewell-LaSalle Realty Co., 72 discussed in detail in the body of the note, which held that "public reception for profit in itself constitutes an infringement of the copyright proprietor's exclusive right to perform." 73 The District Court in Fortnightly felt constrained to follow Buck, citing the fact that in an era of technological development, courts must be flexible in utilizing dictionary definitions. In addition, the Court struck down the defense of an implied-in-law license for commercial TV reception and distribution of a telecast performance. From the Court's point of view, the issue was not whether an implied-in-law license existed, but rather whether the CATV station should be allowed to profit at the licensee's expense—it decided that it should not. It is interesting to note that in Buck, the Supreme Court had pointed out that if the radio station had obtained authorization to broadcast the copyrighted material, the decision might have been different. 74 A lower federal court had held there was no infringement where the initial broadcast was licensed. 75 In holding that such an implied-in-law license should not exist, the Court appears to have made a value judgment based on economic realities rather than judicial interpretation.

The result in this case underscores the flexible approach adopted by the courts in construing Section 1 (c) and (d) of the Copyright Act. 76 In holding CATV liable for infringement, the Court in Fortnightly has significantly advanced the broad protective scope of copyright law.

**DISSOLUTION OF THE CLOSE CORPORATION**

Conceived in practical business necessity, but born into the restraint of existing corporate norms, the close corporation stands today as a species of business enterprise finally achieving its rightful place in the legal spectrum. The typical close corporation is formed by several businessmen who otherwise would have

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71 Ibid.
72 283 U.S. 191 (1931).
75 Buck v. Debaum, 40 F.2d 734 (S.D. Cal. 1929).
76 17 U.S.C. § 1(c), (d) (Supp. 1965). The Court by-passed the other charges made by the copyright owner under these sections and limited the decision to the issue of whether CATV had infringed the performing rights.
sought the partnership as the vehicle of their enterprise. Ordinarily their intended scope of business is relatively limited. The management of the close corporation is dominated by the personal relationships among the shareholders, and usually management and ownership are substantially identical. Shareholders both finance and operate the venture, and are responsible only to fellow shareholders. The skill and personality of each shareholder is of considerable importance to every other shareholder, since their relationship is very much like a partnership.\(^1\) Although a uniform definition is elusive, the close corporation has been characterized for statutory purposes as one with no more than a certain number of shareholders,\(^2\) or one which does not trade its shares on a public exchange.\(^3\)

Perhaps the most significant reason for which businessmen choose the corporate form is that it affords them an opportunity to limit their liability to the capital invested in the business.\(^4\) This characteristic of the corporate form permits immunization of personal fortunes from creditors, while in a partnership, under existing law, liability remains personal if the partnership assets do not satisfy claims.\(^5\) Equally advantageous is the continuity of the corporate life\(^6\) as compared with the automatic dissolution of a partnership upon the death or retirement of one of its members.\(^7\) A third consideration favoring incorporation is the tax benefit which accrues.\(^8\)

The corporate form, however, contains many disadvantages which arise from the personal nature of the close corporation. These discommodities are embodied in the proverbial "corporate norms," perhaps the most onerous of which is that requiring the democratic management of corporate affairs by which majority rule is exercised through both a board of directors and the shareholders.\(^9\) This standard is perfectly suited to a large corporation

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\(^3\) \textit{Fla. Stat. Ann.} § 608.0100(2) (Supp. 1965); see \textit{N.Y. Bus. Corp. Law} § 620(c) (hereinafter cited as BCL).

\(^4\) \textit{E.g., N.C. Gen. Stat.} §§ 55-58(e) (1965); see \textit{Ballantine, Corporations} §§ 1, 2 (rev. ed. 1946).

\(^5\) \textit{N.Y. Partnership Law} § 26; \textit{Uniform Partnership Act} § 15 (hereinafter cited U.P.A.).

\(^6\) \textit{E.g., BCL} § 202(a)(1).

\(^7\) \textit{N.Y. Partnership Law} § 62; \textit{U.P.A.} § 31.

\(^8\) See \textit{Symposium on the Close Corporation}, supra note 1, at 355-61.

whose numerous owners desire such protection, but it is unreal-
istic for small businesses where owners seek the control aspects of
the partnership, including the power of veto. For example, in
the case of a close corporation, statutory schemes providing for
majority control facilitate the "freezing out" of the minority share-
holders. By the adoption of structural changes, issuance of new
shares, refusal to declare dividends, or the alteration of voting
rights, a minority shareholder, with no extra-corporate bargaining
power, and no market for his stock, stands open to substantial
loss.

The majority of states have but one statute which governs
all types of corporations. However, the legislatures of several
states have made major advances in recognizing and solving the
problems, and in accommodating the special needs of the close
corporation. Florida has progressed the furthest in that it has
enacted legislation pertaining solely to the close corporate entity.
North Carolina has generally been credited with being the first
state to extend statutory recognition to the close corporation.
However, since New York has closely followed its lead, the laws
of New York will be considered in this note with reference to
other statutes when they vary significantly from New York's
Business Corporation Law (hereinafter referred to as BCL).

The legislative reforms, while permitting close partnership-
like management, have done little in advancing the equally realistic
application of the dissolution features of the partnership. Partner-
ship dissolution can be judicially obtained when circumstances
render it equitable, and it can always be at the will of any
partner regardless of whether the partnership agreement is
violated. If the agreement is breached, the partner who violates
it is liable in damages to his fellow partner(s). This relationship

10 See Winer, Proposing a New York "Close Corporation Law", 28
CORNELL L.Q. 313, 315 (1943).
11 See Kohler v. Kohler, 319 F.2d 634 (7th Cir. 1963).
12 FLA. STAT. ANN. §§ 608.0100-.0107 (Supp. 1965).
13 Folk, Revisiting The North Carolina Corporation Law: The Robinson
Treatise Reviewed And The Statute Reconsidered, 43 N.C.L. REV. 768,
864 (1965).
15 Burnstine v. Geist, 257 App. Div. 792, 15 N.Y.S.2d 48 (1st Dep't
1928). See N.Y. PARTNERSHIP LAW § 62(2); U.P.A. § 31(2).
is essentially of a personal character and is based on mutual confidence and cooperation. An action to compel performance of the agreement will, therefore, be refused. The parallel between a partnership and a close corporation is quite obvious. Nevertheless, reforms with reference to the close corporation generally have been limited to the correction of the problems arising from greater than majority, or qualified majority rule.

In regard to the operation of the close corporation, the "partners" will wish to secure for themselves a share of the profits and avoid a "freeze-out." Shareholder agreements to this end, traditionally frowned upon, have received legislative sanction in Section 620(b) of the BCL. This section permits the close corporation to encroach upon the formerly inviolate discretion and power of the board of directors in managing the enterprise. By provision in the charter, certain functions may be transferred to the shareholders. Such a provision must be agreed upon by all incorporators or holders of all outstanding shares, voting and non-voting, and notice is required on the face of the shares to assure that subsequent shareholders will be informed of the restrictions. It is further conditioned upon the continued close holding of the shares. To this end, trading of shares on a national exchange is proscribed.

Provisions for greater than majority stockholder quorum and voting requirements, and for greater than majority director quorum and voting requirements, although not new, decidedly give the minority shareholder a more partnership-like control over the operation of the business.

Coinciding with greater minority voice in corporate government has been the increased danger of stalemate—induced corporate

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17 McQuade v. Stoneham, 263 N.Y. 323, 189 N.E. 234 (1934). In this case, defendant, a minority shareholder, by agreement among all shareholders was to be a corporate officer and receive a fixed salary. Eventually, he was voted out of office due to a disagreement. The Court refused specific performance of the contract. See also Long Park, Inc. v. Trenton-New Brunswick Theatres Co., 297 N.Y. 174, 77 N.E.2d 633 (1948); Manson v. Curtis, 223 N.Y. 313, 119 N.E. 559 (1919). While such agreements which had the effect of limiting the discretion of the directors were held to be void, agreements among shareholders as to the manner of voting shares were not proscribed. Ringling Bros.-Barnum & Bailey Combined Shows v. Ringling, 29 Del. Ch. 610, 53 A.2d 441 (Sup. Ct. 1947); Manson v. Curtis, supra at 319-20, 119 N.E. at 561 (dictum); see BCL §620(a); N.C. Gen. Stat. §55-73(a) (1955); Hoffman, supra note 1, at 5-12; see generally Delaney, The Corporate Director: Can His Hands Be Tied In Advance, 30 Colum. L. Rev. 52 (1950); Robinson, "Shareholders' Agreements" and the Statutory Norm, 43 Cornell L.Q., 68 (1957).
18 BCL §616; see Hoffman, supra note 1, at 3-5.
19 BCL §709; see Hoffman, supra note 1, at 3-5.
miscarriage. Consequently, liberalization of dissolution provisions of corporation law became necessary to relieve stifling deadlock situations. In the case of deadlock, prior law provided for dissolution upon the application, by fifty per cent of the shareholders, to a court exercising equitable jurisdiction. However, through the restricted exercise of its discretionary power, for which sanction was found in the statute, the courts accurately reflected the image of the "sacred cow of corporate existence." In the Matter of Cantelmo, typical of this attitude, was a dissolution action wherein a fifty per cent shareholder-petitioner alleged deadlock. The petition was denied not only because all shareholders were not benefited (each received $25,000 salary), but also because the petitioner was actually acting for his own benefit in seeking complete control of the corporation’s business.

In the Matter of Radom & Neidorff, Inc. took a somewhat more extreme position in dismissing the petition of a deadlocked fifty per cent shareholder. Because the corporation had average annual earnings of $71,000 and had sufficient assets, the petition was dismissed in spite of hopeless and irreconcilable deadlock in management, as well as other serious disputes causing inability to elect directors. Benefit to the shareholders and absence of injury to the public were deemed to preclude judicially imposed death. Dissolution would be granted only when management was not efficient and when the corporate objective, presumably monetary, was frustrated. The Radom holding was controlling authority until the BCL.

From these cases, it appears that prior to the BCL, a profitably run business would not be dissolved merely for dissent. The only benefits which the court considered were pecuniary ones. It disregarded the obvious burden imposed upon a shareholder desirous of ending an unsatisfactory personal relationship. Unable to sell shares on an open market, a situation which is the rule in the case of a close corporation, the shareholder was forced

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20 Israels, supra note 9, at 793.
22 N.Y. Gen. Corp. Law § 117. "If ... it shall appear ... that a dissolution will be beneficial to the stockholders ... and not injurious to the public, the court must make a final order dissolving the corporation. ..."
to remain in a relationship which, but for the corporate entity, would be unenforceable in a court of equity.\textsuperscript{28}

Under the BCL's deadlock provision, section 1104(a), the earlier requirement that the petition be brought by one-half of all outstanding shares entitled to vote for directors has been retained. It may be brought on any of three grounds: (1) board deadlock resulting in inability to act; (2) deadlock among shareholders in election of directors; and, (3) internal dissention and two or more factions of shareholders so divided that dissolution would be beneficial to the shareholders.\textsuperscript{29}

The pervasive requirement that the shareholders be benefited has been retained, while the provision for non-injury to the public has been deleted.\textsuperscript{30} However, shareholders' dissent 'making the continuation of the business unworkable and no longer advantageous to the shareholders is, according to legislative intent, a reasonable ground for dissolution.\textsuperscript{31} The proposed effect of the deletion is to make clear, especially in a close corporation, that dissent and the interest of the parties should not be overridden by considerations applicable to corporations in which the public has a greater interest.\textsuperscript{32}

A further important change which appears to overrule Radom is found in section 1111(b)(3) which provides that dissolution is not to be denied merely because the corporation is, or potentially is, a money-making enterprise.\textsuperscript{33} This provision may also be used to broaden the meaning of "advantageous." Whether Radom is, de facto, reversed remains to be seen. Benefit to the shareholders remains the paramount criterion. By the express intent of the legislature, the court is still invested with the power to exercise its discretion in allowing dissolution in order to "insure fairness to all shareholders."\textsuperscript{34} Herein lies the key to future dissolution actions, i.e., the manner of exercise of judicial discretion.

The appellate division recently granted a dissolution in In the Matter of Sheridan Constr. Corp.,\textsuperscript{35} a case governed by prior law but decided subsequent to the passage of the BCL. Two brothers, fifty per cent shareholders, developed such a bitter animosity towards one another that efficient management became progressively less possible until, finally, managerial paralysis set

\textsuperscript{28} See supra note 16.
\textsuperscript{29} BCL §1104(a)(1), (2), (3).
\textsuperscript{30} BCL §1111(b)(2).
\textsuperscript{32} Id. at 69. Cited as examples of public corporations are banks, insurance companies and public service corporations.
\textsuperscript{33} BCL §1111(b)(3). See Hoffman, supra note 1, at 19-20.
\textsuperscript{34} N.Y. Lsg. Doc. No. 12, at 69 (1961).
in. The corporation had suffered losses since 1958 and the situation continuously worsened. There was no alternative but to dissolve the corporation. It is significant to note that the court referred to the present Section 1104 of the BCL and indicated that the impasse was one which fell within the purview of the statute, i.e., an equal number of directors equally divided resulting in complete frustration and standstill, with no hope of reconciliation and no ground for agreement, and, with continuation of the corporation resulting in further deterioration of the situation.\(^3\)

The court in *Sheridan* relied on such a strong set of facts in allowing dissolution that it would appear that if other courts adopt its view as to situations for which section 1104 was intended, decisions thereunder would be barely distinguishable from *Radom*, except in so far as they will no longer emphasize the profitability of the corporation. This would appear to be contrary to the implicit intent of the BCL which is to give proper recognition to the problems of the close corporation. If the key to the courts' future decisions lies in the determination of what is beneficial or advantageous to shareholders, they might well keep in mind a practical close corporation truism stated in an early case:\(^37\)

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\text{Discord and strife began to arise . . . . The parties lost confidence in each other, and their . . . judgments . . . came into serious conflict . . . . The trial court found . . . that the relationship . . . is such that there can be no reasonable hope of future harmonious co-operation; that . . . the property and assets of the company are bound to depreciate and diminish, and that therefore it will be beneficial to all stockholders that the company be dissolved. The mere ability of the minority stockholders to resort to the process of injunction by way of remedying some of the abuses will not bridge the gap now existing between contending factions; nor will it bring about future harmonious co-operation; nor does it furnish a more favorable view of the company's prospects. Quite the contrary is true. Litigation of the character suggested intensifies the feeling between the parties, and makes their relation even more strained. It is the common experience of the business world that embittered litigation between factions in a corporation tends to reduce the value of the corporation's assets. It has a destructive and depreciating effect, which in some cases leads to utter disorganization.}^{38\}
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The courts must, of course, consider the protection of creditors; they must also prevent the exploitation of the less financially able shareholders at a dissolution sale. However, when the corporation is a close one, the owners genuinely schismatic and third parties adequately protected, the courts should give considerable weight

\(^{36}\) *Id.* at 391, 256 N.Y.S.2d at 211-12.


\(^{38}\) *Id.* at 406-08, 168 N.E. at 214-15.
to the desires of the shareholders as well as to the potentially harmful effect of their feud on the corporation.

The partnership aspect of close corporation dissolution is approached in section 1104(c) under which a single shareholder may present a dissolution petition but only after the shareholders have been so divided that directors have not been elected for two consecutive annual meetings. However, it is likely that the courts will require the petitioner to satisfy section 1111(b)(2). If the courts choose to strictly construe the dissolution provisions, it will, no doubt, be most difficult for a single minority shareholder to satisfactorily establish that his petition will be beneficial to all the shareholders. Thus, it will remain difficult for a minority shareholder to rid himself of an unwanted relationship.

The North Carolina statute seems to treat the problems of a minority shareholder in a close corporation more realistically than does New York's statute. At the suit of a single shareholder, a corporation may be dissolved not only for deadlock of the shareholders or directors, but also when liquidation is "reasonably necessary for the protection of the rights or interests of the complaining shareholder." Under this provision, a dissolution petition was held to be sufficient in Royall v. Carr Lumber Co. wherein it was alleged by a holder of thirteen per cent of the outstanding shares, that, although the business was solvent, it had not operated profitably for several years, and the continuation of the condition would result in a diminution in the value of the assets and cause loss to the shareholders. The statute on its face purports to allow dissolution in less severe circumstances, and appears more compatible with a liberal judicial outlook. While New York requires benefit to the shareholders, North Carolina would allow dissolution which would benefit, or at least correct a wrong against, the complaining shareholder. Thus, where a close corporation has reached an economic standstill but still manages a reasonable return to the majority through adequate but not excessive salaries, and an inadequate dividend to the minority, the victim of a subtle "freeze-out," the dissolution requirements of the New York statute would not be satisfied. In such a situation, however, the North Carolina statute could be invoked to provide relief.

Florida, in its new close corporation law, allows any shareholder, without a waiting period, to petition for dissolution in event of a director-shareholder deadlock. In addition, the share-

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32 FLA. STAT. ANN. § 608.0107 (Supp. 1965).
holders are allowed to enter into any written agreement, whether contained in the certificate of incorporation or not, relating to any phase of corporate affairs which would have otherwise been invalid as an attempt "to treat the corporation as if it were a partnership." By this provision, it appears that any "partnership" agreement, including one embodying the dissolution aspects of a partnership, will be enforced by the courts. Certainly, a minority shareholder is at least provided with the means of obtaining and exercising sufficient voting power to cause deadlock sufficient to warrant involuntary dissolution.

The New York statute specifically allows for voluntary dissolution which permits businessmen, as in Florida, to avail themselves, through charter provisions, of the advantages of a partnership. Dissolution may, by agreement, be permitted at the will of any specified number of shareholders or upon the happening of any specified event. Not only serious deadlock, but mere dissension, are among the conditions which may be anticipated. Dissolution at will, however, is a feature peculiar to partnerships. Florida's statute has the advantage of allowing a majority of voting shares of an existing close corporation to elect to be treated as such, whereas New York requires unanimity, a serious drawback to the affected corporations.

In New York, however, Section 1008 of the BCL was designed to protect the interests of third parties. The section allows the court to suspend or annul dissolution upon the petition of the creditors as well as the shareholders or the corporation itself, and permits the court to make "all. . . orders as it may deem proper in all matters in connection with dissolution." Although intended as a recognition of the court's jurisdiction to pass upon the validity of the authorization of dissolution and to supervise the dissolution itself, the section is broadly worded and could be utilized by the courts to restrain the implementation of section 1002 agreements.

Despite the liberalized statutory approach to dissolution, there still remains a wide area in which the shareholders of a close corporation are bound by the traditional restraints upon the corporate entity. Absent deadlock or partnership-like agreement, there is little a minority shareholder can do to remove himself from

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44 See Kay v. Key West Dev. Co., 72 So. 2d 786 (Fla. 1954).
45 BCL § 1002(a).
47 BCL § 1002(b).
48 MCKINNEY'S BUSINESS CORPORATION LAW § 1008, Legislative Studies and Reports.
his unwanted association. This problem can occur where the close corporation was formed prior to the enactment of Section 1002 of the BCL or equivalent legislation. If the required voting power cannot be obtained to amend the original certificate, the minority is unable to take advantage of the new provision. To this incorporated “partner,” the “sacred cow of corporate existence” is still very much alive.

For such a minority shareholder to bring about dissolution, the aid of a court of equity might be sought, but it is questionable whether such aid would be available to him. Although equity has long had the power to order dissolution through its discretion, the power has been traditionally exercised with the utmost restraint. However, there is now emerging a trend toward treating the members of a close corporation as a partnership inter sese, regardless of legislation.

Generally, the instances where equity has acted have been categorized under three headings. The first is the abandonment of the corporate function, either where the corporation has never commenced business or has been inactive for a long period of time. The court will act for a minority shareholder to prevent diminution or dissipation of assets. The second area, and the one in which equity has been most receptive to the petition of the minority, is when there is a failure of the corporate purpose. In *Miner v. Belle Isle Ice Co.*, the court held that the corporate function was to provide a return to its shareholders, and in failing to do so, the corporation was subject to dissolution. The circumstances causing failure consisted of fraud, mismanagement and misappropriation of the corporate assets by the majority shareholders. The court characterized the majority as a fiduciary who, by such practices, abused the trust imposed upon it at the expense of the minority. The majority will not be allowed to ignore the rights of the minority and continue the cor-

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50 See Hornstein, *supra* note 49, at 226-27. See, e.g., *Burg v. Smith*, 222 Ala. 600, 133 So. 687 (1931) (ceased activity for five years with no intent to resume); *Central Land Co. v. Sullivan*, 152 Ala. 360, 44 So. 644 (1907) (ceased to carry on business for fifteen years); *Lind v. Johnson*, 183 Minn. 239, 236 N.W. 317 (1931) (land holdings sold and no meetings for several years); *Lasley v. Walnut Cove Mercantile*, 179 N.C. 575, 103 S.E. 213 (1920) (no use of corporate power for eight years).

51 *Supra* note 49.

poration solely for its own advantage. The third general category, the forerunner of modern statutes, is failure of stockholders or management to work together, resulting in deadlock or dissension.\textsuperscript{53} Relief was granted when dissention was so serious that economic collapse would follow from the continuance of the management. Although this rule applies to all corporations, it has been held to be especially applicable to close corporations.\textsuperscript{54}

The New York courts exercising equitable jurisdiction have historically demonstrated a willingness to aid minority shareholders, but only in cases of extreme overreaching by the majority.\textsuperscript{55} In the leading case of Kroger v. Jaburg,\textsuperscript{56} a dissolution action by minority shareholders of a close corporation, the complaint alleged that the majority shareholder had increased his salary from $7,500 to $20,000 per year, despite business being so unprofitable that the corporation was operating at a loss. Capital was being impaired and it appeared that the waste and dissipation of capital and assets would continue until they were consumed. No dividends had been paid on the common stock. The court determined that the good faith of the majority shareholder was a proper subject of adjudication, and that any breach of trust presented a ground for equitable relief.\textsuperscript{57} While previously it had been held that majority shareholders violated a fiduciary duty by wrongfully seeking corporate dissolution,\textsuperscript{58} the court, here, concluded that bad faith in refraining from dissolving a corporation when it would be beneficial to do so constituted a breach of a duty owed to the corporation and the minority. If, therefore, it could be shown that the refusal of the majority to dissolve the corporation was for the purpose of obtaining the corporate assets for itself by way of salary, rather than dividing the assets among all the shareholders by way of liquidation, it was the duty of the directors,

\begin{footnotes}
\item[56]231 App. Div. 641, 248 N.Y. Supp. 387 (1st Dep't 1931).
\item[58]Kavanaugh v. Kavanaugh Knitting Co., 226 N.Y. 185, 123 N.E. 148 (1919). The Court of Appeals stated that when directors and majority shareholders seek dissolution, it would have to be based upon the belief that the interests of the shareholders generally would be promoted. "In taking corporate action . . . 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." Id. at 195, 123 N.E. at 152.
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enforceable by the court, to institute dissolution and liquidation proceedings.

The New York courts have generally agreed upon the necessary requisites for dissolution but have not always been able to agree as to when they were present. Allegations that the corporation is being continued solely for the purpose of benefiting those in control at the expense of others or that the capital of the corporation is being impaired by the majority's "looting" of assets have generally been held sufficient to state a cause of action. However, mere dissent is not enough for dissolution. In the case of Fontheim v. Walker, the court held that the decision to dissolve was obviously one for the majority where there was mere disagreement. The court, in its reasoning, relied in part on the ability of a disgruntled minority to "separate themselves" from the corporation. However, such reasoning would not be appropriate in the case of a close corporation where there is no market value for the shares. Thus, the minority would be relegated to appraisal rights when there is no readily available market or when the market consists of antagonists.

In 1963, the New York Court of Appeals decided Leibert v. Clapp, which was applauded as "removing the protection heretofore afforded to corporate manipulators who have had the astuteness to cheat minorities with restraint." The petitioner alleged that the majority shareholders were "looting" corporate assets, enriching themselves to the minority's disadvantage and coercing the minority to sell their holdings to those in control at depressed prices. The Court held that the complaint was sufficient to state a cause of action, even though the corporation had been making a profit and had been declaring dividends. In addition, the Court stated that such allegations as those presented went far beyond charges of waste, misappropriation and illegal accumulation of surplus, which might be cured by a derivative action. Settled beyond peradventure is the proposition that, in cases such as this, directors and shareholder majorities—constituted ... guardians of the corporate welfare—are cast in the role of fiduciaries and must exercise their responsibilities as such with scrupulous good faith.

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60 282 App. Div. 373, 122 N.Y.S.2d 642 (1st Dep't 1953) (the corporation involved was not a close one).
61 Id. at 376, 122 N.Y.S.2d at 644.
63 Comment, supra note 55, at 701.
Having failed to fulfill its duty, the board of directors created a “decisional vacuum” into which the Court placed itself.

Thus, no longer need it be alleged that the sole purpose of the corporate existence is to benefit those in control; it is enough that this be the primary purpose. It appears that the standard of fiduciary duty was reshaped, with more emphasis placed on the motives of those in control and less on the outward effects of their bad faith conduct. The effect of Leibert was an extension of the courts’ power to order dissolution in situations where majority shareholders were obtaining a disproportionate share of the benefits without causing an end to profitable operations.

In a dissenting opinion, Judge Van Voorhis, determining that the proper remedy was a derivative action for waste and misappropriation, stated that the allegations failed to show either that the capital was impaired by the “looting” of the assets, thereby enriching the majority stockholders at the expense of the minority, or that the existence of the corporation was being continued solely for the benefit of those in control. He regarded plaintiff’s action as an attempt to subvert the security requirements of a derivative action. Although Leibert did not involve a close corporation, the holding as applied to one certainly adds impetus to the recognition of a problem peculiar to a close corporation, i.e., sophisticated “freezing-out” without the benefit of a public market and, as such, the holding may be characterized as another movement in the trend.

The advance of equity towards full partnership-like dissolution reached its furthest extension in the 1965 New York case of Kruger v. Gerth. The importance of the decision is found not in the majority opinion, which is somewhat restrictive, but in the minority opinions. The majority merely affirmed the opinion of the appellate division, where it had been determined that there was no evidence from which the elements necessary for involuntary dissolution, i.e., looting and impairment of capital, or maintenance of the corporation for the benefit of the majority stockholder at the expense of the minority, could be deduced. The Court also found no evidence to indicate that the defendant did not deserve the salary increases and bonuses. It viewed plaintiff’s claim as

65 See id. at 317, 196 N.E.2d at 543, 247 N.Y.S.2d at 106. See id. at 320, 196 N.E.2d at 545, 247 N.Y.S.2d at 109 (dissenting opinion).
66 Comment, supra note 55, at 699.
67 Id. at 701.
69 See BCL § 627.
resting only upon the fact that the amount of the bonuses served to reduce the net profit of the corporation, so as to leave an insufficient amount to provide a fair return to plaintiffs. The court stated that it had found no case wherein dissolution was granted on such a meager showing. Distinguishing Leibert, the court observed that the plaintiff here made no allegation that the impairment in the value of the capital stock served to coerce the minority to sell their shares at depressed prices. It was also noted that since one of the plaintiffs, all of whom had originally received their shares through bequest, was a competitor of the defendant corporation, possibly the real motive for bringing the action was to enhance the value of this competitor’s business.

Chief Judge Desmond, dissenting, found ground for reversal on the authority of Leibert v. Clapp and upon the similarity of the partnership and the close corporation, which, he declares, should be treated alike in many respects by a court of equity. Here, one “partner” had died. The corporation had once existed as an enterprise formed and operated by the combined efforts of two individuals and was formerly indistinguishable from the “partners.” Now it is being kept alive solely for the benefit of the survivor. If the survivor were to pass away, no one would consider continuing the business. There was no profit, no growth potential and no market for the stock. The only way in which all stockholders, as such, could be benefited was through dissolution—looting was not considered necessary.

This approach recognizes the separate corporate entity and expands the fiduciary duty of the majority commensurate with the nature of the relation. Two questions will be asked in a dissolution proceeding in following this approach. First, is the business healthy, not, is it dying? Second, if it is not healthy, is its decline due to the personal nature of the business? If answered in the affirmative, dissolution should follow.

Judge Fuld, also dissenting, goes beyond the fiduciary principle and realistically views the parties for what they are, i.e., as partners, but as partners existing “wholly apart from their corporate creature to the world at large.” There is, he adds, “no inherent reason why a court of equity cannot treat the participants in a genuine close corporation, insofar as their relationship inter se is concerned, as they regard themselves, as partners or joint

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73 Compare Matter of Sheridan Constr. Corp., 22 App. Div. 2d 390, 256 N.Y.S.2d 210 (4th Dep't), aff'd, 16 N.Y.2d 680, 209 N.E.2d 290, 261 N.Y.S.2d 300 (1965), where there were acute losses and demise was interpolated from the facts. Id. at 392, 256 N.Y.S.2d at 212.

74 Kruger v. Gerth, supra note 72, at 806, 210 N.E.2d at 357, 263 N.Y.S.2d at 3.
venturers." Significantly, he endorses the analogizing of this relation to a partnership at will. The court would, therefore, be able to direct the shareholders to vote for dissolution (and, if necessary, appoint a receiver) upon any petition of a minority shareholder, not in his capacity as owner of a corporation, but rather in his capacity as a partner in a firm having as its chief assets the shares of the corporation.

Judge Fuld has, by cutting away the form and reaching the substance of the close corporate relation, exposed the relation to another equitable concept, recently espoused as a solution to close corporation problems, i.e., the refusal of the court to grant specific performance of a personal contractual relationship. It has been suggested that refusal to dissolve may amount to specifically enforcing against the petitioner the respondent's version of the relationship. Indeed, it is this very principle which renders partnership existence so soluble and dissolution preferable. Just as in a partnership based on personal confidence, the close corporation can seldom be continued advantageously amid discord and thus falls within the same rationale.

If a jurisdiction becomes disposed towards acceptance of the partnership analogy, it is faced with the perplexing question as to whether society's need for, and benefits to be gained from, such enterprises outweigh the potential harm. Essentially, the protection of limited liability would be bestowed upon the former partnership. To carry the trend to its extreme would encourage speculative enterprises to hide behind their parapets of limited liability, unresponsive to their public and private responsibilities. However, in a partnership, it is a sobering thought to partners who act recklessly that their personal fortunes are jeopardized whenever

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75 Id. at 806, 210 N.E.2d at 357, 263 N.Y.S.2d at 4. Judge Fuld cites DeBoy v. Harris, 207 Md. 212, 113 A.2d 903 (1955) and La Varre v. Hall, 42 F.2d 65 (5th Cir. 1930) as examples of the trend towards recognition of a close corporate entity. DeBoy involved a breached pre-incorporation agreement aimed at preventing a "freeze-out" of the minority-petitioner. The court held that the agreement survived the incorporation and that it rendered the parties, for the purpose of an equitable accounting, partners or joint venturers.


77 See 4 POMZNOY, EQUITY JURISPRUDENCE §§ 1343, 1402 (1941).


79 See Karrick v. Hannaman, 168 U.S. 328, 334-35 (1897); Lapenta v. Lettieri, 72 Conn. 377, 44 Atl. 730 (1899).

80 Israels, supra note 76, at 789. "Deadlock or stalemate in a close corporation is as completely socially undesirable as in a partnership or in a marriage . . . ." Ibid.
they incur debt or act negligently. Such partners will, therefore, be restrained from “closing-shop” at the least suspicion of financial reverses. Rather, the existing business, however limited, will be preferable to dissolution so long as it tends to insulate the partners from their creditors.

The trend toward treating the close corporation as a partnership for the purpose of operating the business is realistic, if not advantageous, with respect to the protection of third parties. But, in the desire to base a close corporation law on its own assumptions, the concept of limited liability cannot be forgotten. Just as corporate norms were formulated for big business, the privilege of limited liability primarily finds its raison d’être in the same source. The courts of equity, most particularly, must steadfastly recognize the rights of third parties. Piercing the corporate veil in the face of proven fraud, and appointment of

81 See Cataldo, Limited Liability With One-Man Companies and Subsidiary Corporations, 18 Law & Contemp. Probs. 473, 474 (1953). The reason generally put forward for limited liability is that the corporation is a legal entity separate from its shareholders. See, e.g., Nettles v. Childs, 100 F.2d 952 (4th Cir. 1939); Coryell v. Pilkington, 39 F. Supp. 142 (S.D. Fla. 1941), aff’d, 128 F.2d 702 (5th Cir. 1942), aff’d, 317 U.S. 406 (1943). Under the theory advanced by Judge Fuld, limited liability continues to be justified upon this rationale. Beyond this general rule, limited liability finds its basis in the need for capital formation. See BALLANTINE, CORPORATIONS § 1 (1946). Without protection from creditors of the corporation, an investor merely seeking a return on his capital would be hesitant in buying shares. Upon this rationale, the necessity of limited liability is not as obvious in a close corporation. To extend the limitation, a determination must be made that there exists a need for expansion of small businesses. It is obvious that one would not be hard pressed to find such justification.

From the point of view of third parties, limited liability is compensated for by the size or by the potential for growth of other than a close corporation. Thus, the same determination of need is necessary. This is not to relieve creditors from all responsibility in their dealings with small businesses, but the possibility of fraud or mere overextension of credit through poor judgment cannot be discounted.

82 Accord, Bartle v. Home Owners Co-op., Inc., 309 N.Y. 103, 127 N.E.2d 832 (1955). See Anderson v. Abbott, 321 U.S. 349 (1944). “An obvious inadequacy of capital, measured by the nature and magnitude of the corporate undertaking, has frequently been an important factor in cases denying stockholders their defense of limited liability.” Id. at 362. Accord, Luckenbach S.S. Co. v. W.R. Grace Co., 267 Fed. 676 (4th Cir. 1920); United States v. Milwaukee Refrigeration Transit Co., 142 Fed. 247 (E.D. Wisc. 1905). Although a corporation is a separate entity, it is well settled that “when the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime, the law will regard the corporation as an association of persons.” Id. at 255. See generally BALLANTINE, CORPORATIONS §§ 118-42 (1946).
receivers in necessary cases\textsuperscript{83} have always been within its power. Statutory dissolution provisions are replete with protective sections.\textsuperscript{84}

However, when the problem of dissolution comes down to a controversy involving the personal relationship between individuals, the court of equity should not presumptively refuse to grant relief.\textsuperscript{85} Borrowing from the law of partnership, bad faith can be compensated by damages in appropriate cases. "Flexibility of remedy, tailored to all facts and circumstances of the case, including the good faith of the parties on both sides, their conflicting interests and motivations, if any, is the key."\textsuperscript{86}

\textsuperscript{83} See, \textit{e.g.}, BCL § 1202. See generally BCL art. 12.
\textsuperscript{84} \textit{E.g.}, BCL §§ 1008, 1111.
\textsuperscript{86} Kruger \textit{v.} Gerth, \textit{supra} note 72, at 807, 210 N.E.2d at 357, 263 N.Y.S.2d at 5.