The Stockholder's Remedy of Corporate Dissolution (Book Review)

Robert A. Kessler
BOOK REVIEWS


This book is actually a reprint of a dissertation for the Doctor of the Science of Law degree which Mr. Tingle, I assume, received largely as a result of this work. It is commended by the Dean of Mr. Tingle's undergraduate law school, the University of Montana, and a professor from the University of Michigan from which he received his graduate degree.

Mr. Tingle tells us in the preface (and this is borne out in the book itself) that the work is divided into three parts. Chapter 1 is devoted to dissolution on the ground of majority oppression. The next three chapters discuss dissolution on the ground of "deadlock," while the last (fifth) chapter is devoted to the author's proposals for adequate legislation on the subject.

Chapter 1 starts off abruptly, using perhaps what is supposed to be a Maugham touch, with the facts of a Michigan case, the citation of which is given to us on the fourth page of the text (called, however, page 20), the holding of which Mr. Tingle approves (p. 34). A "flashback" discussion of the common law is then given us, devoted primarily to showing us that a court of equity has an inherent right to dissolve corporations, before we return to the conclusion to be drawn from the "big" case (Miner v. Belle Island Ice Co., 93 Mich. 97, 53 N.W. 218 (1892)), that "the majority must have shown that they can no longer be trusted to manage the corporation fairly in the interest of all stockholders; in a word that they are incorrigible" (p. 43) before dissolution for majority oppression will be decreed.

After a review of statutes on the subject, however, Mr. Tingle seems to conclude that maybe it would be better if the majority were forced to buy out the minority instead of having a dissolution (p. 63).

After this rather inconclusive discussion, the author goes on to the main subject of the book, dissolution as a result of deadlock. A short chapter is devoted to drawing the analogy between corporate and partnership dissolution, and suggesting that the test for corporate dissolution should be, as it is for partnership dissolution, "whether mutual confidence and cooperation persist." (p. 73) The test should not be, as is repeated a number of times later, whether or not the corporation is able to operate at a profit despite the
conflict among the participants, but should rather be whether or not there has been a denial of management participation to the offended group (pp. 74, 102, 117, 118, 119, 127, 187, 188).

The author concludes this chapter by drawing an interesting distinction between complete and incomplete deadlock. These are defined as follows (p. 75):

A deadlock may arise when the control of a corporation is equally divided between two stockholders or factions. As noted, usually but not always this requires an equal division of the controlling stock. To simplify the present definition of deadlock the discussion will be in terms of an equal division of shares. Deadlock takes different forms. If the directory is odd-numbered an equal division of the stockholders results in the fortuitous control of that faction represented by a majority of the directors. The directory holds over until its successors are elected, and it is able to function. This is the sense in which “holdover” will be used when it describes a directory. Such a directory of course represents only one faction. This may be called incomplete deadlock. If the directory is even-numbered and the directors and stockholders divide equally on corporate decisions, management by the directory fails. If the business continues it will be the work of holdover executive officers or usurpers. This kind of deadlock may be called complete deadlock. The cases will demonstrate that each kind of deadlock violates the right to participate in corporate management.

Chapter 3 discusses dissolution at common law in terms of these two types of deadlock. Chapter 4 is devoted to cases of both types of deadlock as affected by statutes purporting to authorize deadlock dissolution.

An elaborate case by case, and case on statute discussion, with ample citation of decisions and overly-ample factual treatment of the cases themselves (one gets the feeling that a number of student “briefs” have been strung together, which the author’s cavalier attitude toward the old grammatical requirement of complete sentences—see pp. 85, 87, 89, 118—reinforces) concludes with the not unexpected finding that in the majority of jurisdictions, whether or not they have statutes on the subject, the courts are reluctant to decree dissolution where the corporation, despite the deadlock, is able to operate at a profit (pp. 128, 174).

The result under the decided cases is the same whether there is complete or incomplete deadlock, as the author has defined these phenomena. The distinction is insignificant, however, by this point, since the cases themselves do not draw it, and the author, too, indicates its practical unworkableness by departing from it himself. For example, he suggests on pages 126-27 that an appropriate standard for dissolution in the case of incomplete deadlock is the failure of a directory to represent a majority of the shareholders, a manifest impossibility if the author’s definition of incomplete deadlock is accepted, since the board can never represent a majority of the shareholders where there are only two, each owning an equal number of shares.
The author might have reached this conclusion, that courts are reluctant to dissolve profitable corporations even though their participants are at loggerheads, by a lot less effort on his own part, and that of the reader, through more condensed writing, but then this dissertation would have been merely a brief law review article (as I think it perhaps should have been) rather than a book. I am perhaps overly suspicious of a book which starts on page 17, finds it necessary to add footnotes numbered 137a (p. 52), 1a (p. 65), 6a (p. 67) etc. (obviously at the last minute), and devotes 20 (almost a tenth) of its numbered pages out of a total of 238 to the Table of Cases and Index. Big type and wide margins are, of course, a help in reading. Perhaps, also, every hour of research should produce an amount of print proportional to the effort. Obviously, my opinions (as the author of overly-long law review articles, and only chapters in a book) to the contrary are not completely above suspicion. I cannot help but think, however, that the book is "padded."

This statement is obviously not to be interpreted as detracting from Mr. Tingle's scholarship. He has made an extensive study of the subject, and his concluding chapter, which sets out a minutely detailed proposed statute for solving the problem of corporate dissolution is certainly the result of a great deal of thought. (Since I have, upon occasion, attempted to draft proposed statutes, I am fully aware of the amount of work involved.)

Chapter 5, then, is the culmination of the study. After the overly-long exposition (128 pages) of the common-law cases on deadlock dissolution, and the disproportionately short chapter on statutes authorizing deadlock dissolution (46 pages, when 21 states have enacted statutes on the matter) we finally get Mr. Tingle's ideas on the subject of a proper statute for corporate dissolution based on deadlock. Dissolution for majority oppression is also included, as the first part of the suggested law. Here, for some reason, space-saving is attempted, so we do not get a copy of the entire statute as proposed, but must be content to piece it together from the various places in the text in which its parts appear. This is unfortunate since the text omits the designation "A" before the first part of the statute on page 180, leading to confusion when references are later made to (A) (1) and (A) (2) on page 209, unless one remembers that a footnote (20) on the earlier page gives us the commencement of the statute.

Consistent with his conclusion that incorrigibility is the proper test for dissolution where the majority is oppressing the minority (see p. 182), the proposed statute allows such dissolution:

(1) When those in continuing control of the corporation have by illegal, fraudulent, oppressive, or other action or inaction demonstrated that they can no longer be trusted to control the corporation in good faith toward all of its stockholders.
After a subsection (p. 184) setting forth the "purpose" of the above section, Mr. Tingle goes on to give us his suggested provisions for deadlock dissolution. Dissolution is to be granted:

(2) When participation in the executive management of the corporate business is denied to a plaintiff (or plaintiffs voting continuously as a unit) owning a percentage of the corporation's stock sufficient to cause a stalemate in an election of directors.

"Participation" is denied, we are told, when the plaintiff is "excluded from the executive management of the corporate business," or "cannot longer participate therein, under conditions of mutual confidence and cooperation." (p. 196) The purpose of the section is to allow dissolution only where there is "irreconcilable dissension." Where the plaintiff himself is the cause of this dissension, dissolution is to be denied except where the court determines that "mutually confident and cooperative joint management is impossible or improbable." (p. 196)

The dissolution for majority oppression section is designed to protect the shareholders' "interest" (in the Poundian sense), in "corporate management in good faith, more specifically, the honest acquisition and distribution of profits." (p. 185) The provision for deadlock dissolution is devised to protect the shareholder's "right to participate in corporate management," (pp. 187, 188) the interest which Tingle feels dissolution for deadlock statutes are really designed to safeguard.

I am not so sure that dissolution should ever be granted for "majority oppression," even were the standard to be (if it could be) less vaguely expressed than Tingle proposes. In a footnote, (p. 181 n. 22) he states that "probably" Henry Ford's actions as principal stockholder in failing to declare dividends, the subject-matter of the famous *Dodge v. Ford Motor Co.* case, 204 Mich. 459, 170 N.W. 668 (1919), would not meet the test for dissolution under his majority oppression provision. Let us hope not. Tingle concedes, in a number of places, that "liquidation is harsh." (p. 208; see also, pp. 41, 47, 64) In a large corporation, other remedies are usually sufficient (e.g., a shareholder's suit as in the *Ford* case). The "oppression" may perhaps be viewed as a continuing nuisance, and thus justify a more drastic remedy to avoid a multiplicity of lawsuits. It is more likely, however, in a public issue corporation where the "majority" is widely dispersed among small shareholdings that this will not be the case, for the simple reason that any continuing "oppression" will turn out to be an honest business judgment and hence not oppression at all. In a close corporation, I am tempted to agree with the view of one of the cases that Tingle criticizes. The oppressed participants have only themselves to blame and hence do not deserve help. (p. 83) In a close corporation, the minority participant has a number of ways of protecting himself from such oppression, the principal one being to assure himself a "veto" over all corporate decisions through high vote requirements.
If he does not exact such a concession from the majority participants he has only himself (or his inadequate lawyer) to blame for his plight. As Tingle concedes, dissolution itself may be a form of oppression (p. 209). Such a statute as he proposes may make it an instrument of minority oppression, which is certainly as bad as, if not worse than, oppression by the majority.

With regard to his dissolution for deadlock provisions much the same thing can be said. Clearly he is right in asserting that dissolution should not be denied merely because a deadlocked corporation is still able to operate at a profit. His summary of the New York cases (pp. 137-61) demonstrates that they were incorrectly decided, because made to turn exclusively on the continued profitability of the corporation. He is, however, wrong in rejecting economic factors as the interest to be protected in such deadlock dissolutions in favor of exclusion from participation in management. This should not be the criterion for two reasons: first, participation in management, although it may be the most effective guarantee of the actual end, is not an end in itself, (hence, not a real "interest") but instead only a means to the economic end of a fair distribution of the corporate profits, which is what the participants really want; and, secondly, even if participation is really the desideratum, the shareholder again has only himself to blame if he fails to secure such participation through appropriate charter, by-law or shareholder agreement provisions, and liquidation should not be available to extricate him from his bad bargain at the expense of the other participants (see p. 41).

Often, in reality, it is not the denial of participation which produces the situation calling for dissolution, but its very opposite. The famous case of Matter of Radom & Neidorff, 307 N.Y. 1, 119 N.E.2d 563 (1954) is a good example. The very reason for the deadlock was the power which the defendant equal shareholder held over corporate policies. Her right to equal management participation was the cause of the irreconcilable conflict which justified the dissolution (mistakenly denied because there was not complete economic paralysis of the corporation).

There are too many intangibles, all of which must be weighed in each case, and differing with each case, to set a precise rule decreeing automatic dissolution on any one circumstance, even were the correct one chosen (and I don't believe that denial of participation in management is a correct one). The approach taken by the proposed new New York Business Corporation Law seems sounder. Dissolution is still left to the discretion of the court (thus allowing a consideration of the potential harm to all parties from a forced sale, and a balancing of the advantages against the foreseeable disadvantages), as case law under the present statute has held it to be. However, to guard against the judicial over-reluctance, pointed out by Mr. Tingle, to dissolve a profitable corporation, it is expressly provided that "dissolution is not to be denied merely
because it is found that the corporate business has been or could be conducted at a profit.” (S. 3316, s. 11.23) Further, in addition to the old “complete deadlock” provisions, as Mr. Tingle would call them (petition where the directors’ or shareholders’ votes are so divided as to cause a stalemate), dissolution may also be petitioned where “there is internal dissension and two or more factions of shareholders are so divided that the corporation’s business cannot longer be conducted with advantage to the shareholders.” The profit test suggested by the latter words would seem appropriately negatived by the statutory caveat already discussed.

The new statute also allows, without the shareholder percentage requirements found for an action on any of the above grounds, a petition for dissolution “on the ground that the votes of the shareholders are so divided that they have failed, for a period which includes at least two consecutive annual meeting dates, to elect successors to directors whose terms have expired. . . .” (S. 3316, s. 11.05) Although Mr. Tingle might criticize the latter as dealing with the “symptoms” rather than the real disease of corporate deadlock (see p. 195), such a symptom is a pretty good indication of the presence of such deadlock, itself not a symptom of lack of corporate participation, but merely of internal dissension harmful to at least one of the shareholders, and hence calling for action by the court to safeguard the interests of all.

The proposed New York provisions are perhaps not perfect, but they are flexible enough to authorize a court to decree dissolution when, after that fine balancing of harms versus benefits to all of the shareholders, it decides that dissolution is the best course open. Further, although an appropriate guide is given (i.e., dissolution may not be denied merely because the corporation is still in good financial condition), it is not so rigid as to require dissolution merely because one participant has been, through his own fault, voted off the board of directors, a case in which dissolution may well be to everybody’s financial disadvantage, including that of the objecting plaintiff.

Although the two basic statutory provisions, that for dissolution for oppression and that for deadlock dissolution, suggested by Mr. Tingle, do not seem satisfactory, his “ancillary provisions” might well merit serious consideration by statutory revisors. At the end of the book he returns to the idea that dissolution is a drastic remedy, and the thought that a buy-out of one faction by the other might be preferable.

Even though an action for dissolution has been commenced, “any stockholder wishing to end the proceeding should be permitted to buy the stock of the plaintiff.” (p. 199) Provision is also made for possible purchase of the defendant’s stock by the plaintiffs. (pp. 214-16) The full texts of Mr. Tingle’s various statutory sections are too lengthy to set forth here, but, in general, they are designed to insure that, regardless of who brings the action,
innocent shareholders will receive the full value ("the price that an informed investor would pay for the shares as a continuing investment if the corporation were being controlled and managed in good faith"—p. 206) of their shares whether the corporation is liquidated or they are bought out, thus protecting their real financial interest. Appraisal provisions are added to assure (as well as that "black art" can) that this real value will be fairly ascertained (pp. 205-06).

Whether or not Mr. Tingle's statutory language is an improvement over the three enacted statutes (those of California, West Virginia and Connecticut—pp. 198-99), he is clearly correct in proposing a buy-out at appraised values as a means of obviating liquidation. Authorizing the court, as an alternative to decreeing dissolution, to order one opposing faction to purchase the shares of the other at their fair value is a desirable addition to any deadlock dissolution statute, since this is obviously a more satisfactory way to break the deadlock than a forced sale. The danger of grave financial injury to one or perhaps both of the warring factions from liquidation is probably the real reason for the reluctance of courts to dissolve solvent corporations. They would undoubtedly welcome this less "drastic," because less harmful, alternative.

Robert A. Kessler.*