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A. T. Smythe Jr.

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DISSOLUTION OF CORPORATIONS

CHAPTER 1.12

A. T. SMYTHE, JR.*

Dissolutions are treated in Chapter 1.12 of the act. The following are the statutory grounds for dissolution:

(1) voluntary dissolution; (2) dissolution by expiration of charter; (3) dissolution by forfeiture; (4) judicial dissolution on petition of Attorney General showing abuse of authority or fraud in the procurement of the articles of incorporation; (5) dissolution pursuant to provision in articles of incorporation; (6) dissolution pursuant to court order. It is necessary to note that (6) is authorized in the event of managerial deadlock, of fraudulent management, of misapplication of assets, of abandonment of business, or of insolvency.

While not intending simply to paraphrase the act, discussions of the various types of dissolution will emerge in the order in which they appear in the act.

I. VOLUNTARY DISSOLUTIONS

A. *By act of the incorporators* (section 12.22-1). Prior to the commencement of any business or the issuance of any shares, the incorporator or incorporators may voluntarily dissolve the corporation by following the procedure outlined in the act.

B. *Voluntary dissolution by shareholders* (section 12-22.2). At a meeting of stockholders called in accordance with the provisions of the act, the corporation may be dissolved by a vote of at least two-thirds of the outstanding shares and, if the shares are entitled to vote by classes, then by two-thirds vote of each class so entitled to vote, unless the articles of incorporation provide for a greater percentage. It should be noted that this is a change from the present statutory requirement of a simple majority. However, it must be read in the light of section 12-22.14 of the act, which is a new section not appearing in the Model Act, and which provides for the possibility of dissolution by any shareholder or by

*Buist, Buist, Smythe and Smythe, Charleston, S. C.

any specified number or proportion of shareholders if the articles of incorporation so provide. Reading the two sections together, it is apparent that in the absence of any provision in the articles of incorporation, then a vote of two-thirds of the outstanding shares is necessary for dissolution; but the articles may require a greater percentage or may provide for a lesser.

C. *Voluntary dissolution by written consent of all shareholders* (section 12-223). If all shareholders sign a written consent, the necessity for a shareholders meeting is obviated.

II. DISSOLUTION BY EXPIRATION OF CHARTER (SECTION 12-22.4)

Because of the fact that charters so seldom provide for expiration by their own terms, no discussion of this section seems necessary here, the reader being referred to the statute.

With respect to all of the above procedures, the act of filing the statement of intent to dissolve is to terminate the right of the corporation to conduct business except for the purpose of winding up its affairs and liquidating. The procedure which the corporate management should follow during such interim period is outlined in the act in sections 12-22.5 and 12-22.6.

Should the shareholders have a change of heart during this liquidation period, provision is made for revocation of the dissolution proceedings.¹ These sections require the vote of two-thirds of the outstanding shares for such revocation. While the revocation of a dissolution once commenced may not frequently occur, it should be noted that the act does not require a vote by classes of stockholders for such revocation, simply stating that a vote of two-thirds of all outstanding shares may terminate a dissolution. Also, the act does not specifically authorize this percentage to be changed by provision in the articles of incorporation. Perhaps the effectiveness of such a provision in the articles of incorporation does not require statutory approval. However, a question might arise should the articles of incorporation, pursuant to section 12-22.14, provide for dissolution by the holders of less than one-third of the outstanding stock and, upon the commencement of dissolution, should the holders of two-

1. S. C. CODE §§12-22.7–12-22.9 (Supp. 1962).

thirds or more of the outstanding stock vote pursuant to section 12-22.7 to revoke the dissolution proceedings.

As in the case of commencing a dissolution, no meeting of stockholders is necessary if all the stockholders sign a written consent to their revocation.²

Upon the completion of the liquidation of the corporation, articles of dissolution are filed, the corporate existence thereupon terminating.³

III. DISSOLUTION BY FORFEITURE (SECTION 12-22.11)

The corporation is to be given a ninety day notice by the Secretary of State of the impending forfeiture of its charter upon any one of the following omissions:

(a) To file its annual report; (b) To pay its franchise tax; (c) To appoint and maintain registered agent; or (d) For thirty days after a change of registered office or registered agent to file with the Secretary a notice of such change. Upon the failure of the corporation to cure the omission within ninety days, the Secretary shall file in his office a declaration of dissolution of the corporation. He shall send a copy to the corporation at its last known address and publish the fact of dissolution in a newspaper published or circulated in the county where the corporation maintained its last known registered office.

Within a year after such dissolution, one or more of the corporate directors may deliver an application for re-instatement; and, upon the curing of the omission which caused the forfeiture, the Secretary of State shall file such application. As of the date of such filing, the corporate existence shall be deemed to have continued without interruption from the date of dissolution.

The act provides in section 12-22.12(b) that after dissolution by forfeiture, should the application be made for reinstatement as above provided and duly filed, "reinstatement shall have no effect upon any issue of personal liability of directors, officers or agents of the corporation during the period between dissolution and reinstatement." The effect

2. S. C. CODE § 12-22.8 (Supp. 1962).

3. S. C. CODE §12-22.10 (Supp. 1962).

of this provision in the act may be the subject of litigation and its exact meaning is not clear. The language does not appear in the provisions of the Model Act nor does it appear in the acts of many states which have adapted the Model Act to their needs, as has been done with the passage of the subject act in South Carolina. The question is: In the absence of fraud, assuming the ignorance of the corporate officers and the third party, if corporate officers after a dissolution due to forfeiture deal with third parties in the name of the corporation, such third parties relying on the corporate credit, and thereafter the forfeiture is discovered and cured, should the corporate officers be personally liable to such third parties for their acts during the period between dissolution and reinstatement?

An interesting article reviewing the cases on the subject is to be found in the Maryland Law Review.⁴ That article is based primarily on an unpublished decision of the Baltimore City Court, but several other interesting decisions were also considered. These cases show that, on occasion, corporate officers do act for corporations when none of the parties involved are aware of a forfeiture. If, after reinstatement, the officers are to remain individually liable for their acts during such period of forfeiture, then upon a subsequent insolvency of the corporation the officers will have an unexpected liability and the creditors will have an unexpected remedy. In those acts in which no mention is made as to the effect of reinstatement upon the liability of corporate officers, the courts have not hesitated to refuse to find personal liability, where there has been no fraud and where the parties have not contracted with that result in view. If the saving language in the South Carolina act is intended to mean that under all circumstances officers will be personally responsible for any acts during the period of forfeiture, even after reinstatement, then the penalty for forfeiture may be severe indeed. Failure to pay the annual franchise tax could become much more important than failure to pay the annual income tax.

IV. JUDICIAL DISSOLUTION ON PETITION OF ATTORNEY GENERAL (SECTION 12-22.13)

If a corporation continues to exceed or abuse the authority conferred upon it by law, or has procured its articles of in-

4. 19 Md. L. Rev. 151 (Spring 1959).

corporation through fraudulent misrepresentation or concealment of a material fact, it may be dissolved by a decree of court in an action brought by the Attorney General. The Attorney General is directed to bring such an action whenever he determines that the public interest warrants; and in other cases where satisfactory security is given to indemnify the state against the expenses to be incurred in the action.

V. DISSOLUTION PURSUANT TO PROVISION
IN ARTICLES OF INCORPORATION
(SECTION 12-22.14)

The articles of incorporation may provide for dissolution by any shareholder or by any specified number or proportion of shares, either at will or upon the occurrence of any specified event. This section applies only to corporations whose shares are not traded on any exchange or “regularly traded in any over-the-counter market” and has provisions for notice to shareholders.

Similar provision does not appear in the Model Act, and it is presumed that this section is intended to facilitate treatment of closely held corporations as partnerships, and to allow the parties to contract for dissolution upon such terms as seem appropriate to them upon the inception of the corporation.

VI. DISSOLUTION PURSUANT TO COURT ORDER
(SECTION 12-22.15—12-22.17)

The only prior statutory authorization for dissolution by court order, 1952 Code section 12-651, is upon the petition by a minimum minority percentage of stockholders showing that the corporation has either made no earnings for a certain period of time or has failed to pay dividends for a certain period of time, the exact requirements varying with the corporate condition. Thus 20% of the stockholders may petition for dissolution should the corporation make no sufficient net earnings to pay any dividend for a period of three years, commencing not sooner than three years after organization of the corporation; or, regardless of earnings, has not in fact paid any dividend for five years preceding such application. Likewise the court may consider a petition by 10% of the stockholders asserting that the corporation has paid no dividend for ten years preceding the application.

The meeting of the minimum statutory requirements is not binding upon the court, and does not *ipso facto* entitle the minority stockholders to have the corporation dissolved⁵

Additionally, the inherent power of the court to intervene in corporate affairs in the absence of statutory authority has long been recognized.⁶

Under the new act, the statutory remedy for dissolution by court order has been freed from any specific mathematical formulae with respect to net earnings or the payment of dividends, and now grants the court discretion to act under a wide variety of circumstances and in a wide variety of ways. The statutory grounds for a court-order dissolution are set out in section 12-22.15 of the new act. Likewise in section 12-22.23 it is provided that under any of the circumstances mentioned in section 12-22.15 the court may make such order or grant such relief, other than dissolution, as in its discretion it deems appropriate. Specifically, the court is authorized to cancel or amend any provision in the articles of incorporation or in the by-laws; to cancel or enjoin any resolution or other act of the corporation; to direct or prohibit any act of the corporation or of corporate management; and to provide for the purchase at an established fair value of the shares of any shareholder either by the corporation or by other shareholders.

The statutory grounds for court action as set out in section 12.15 deal with action originating from each of three sources: by shareholders, by creditors, and by the corporation itself.

First. Action may be brought by a shareholder when it is established that (1) the directors are so divided respecting management that votes for effective action cannot be obtained; (2) the shareholders are so divided that they have failed to elect successors to directors whose terms have expired; (3) the shareholders are so divided that effective action cannot be taken by the corporation; (4) the acts of management are illegal, fraudulent or oppressive as to the corporation or as to any shareholder; (5) the corporate assets are being misapplied or wasted; (6) the petitioning shareholder has a

5. *Towles v. South Carolina Produce Ass'n*, 187 S. C. 290, 197 S. E. 305 (1936).

6. See cases in WEST'S DIGEST, CORP., key number 551 *et seq.*; *Klugh v. Coronaca Milling Co.*, 66 S. C. 100, 44 S. E. 566 (1903). With respect to corporate deadlock of a solvent corporation, see *D. A. Thompkins Co. v. Catawba Mills*, 82 Fed. 780, 785 (Dis. S. C., 1897) *semble*.

right under some provision of the articles of incorporation to dissolution; or (7) the corporation has abandoned its business, and has failed to take steps to dissolve.

Second. Action may be brought by a creditor when it is shown that the claim of the creditor has been reduced to judgment, execution return unsatisfied, and it is established that the corporation is insolvent; or the corporation has admitted in writing that the claim is owing and it is established that the corporation is insolvent.

Third. The court may act in respect to dissolution upon an application by the corporation itself which has filed a statement of intent to dissolve and desires to have its liquidation continued under the supervision of the court; or when an action has been filed by the Attorney General to dissolve a corporation and it is established that liquidation should precede the entry of a decree of dissolution.

Dissolution on the petition of a shareholder shall not be denied solely because it is found that the business of the corporation has been or could be conducted at a profit.⁷

The act then proceeds to provide in detail for the procedure to be followed in suits for judicial dissolution, including provisions as to parties, as to court powers (section 12-22.16), as to the appointment, duties and qualification of receivers (section 12-22.17), as to the filing of claims in liquidation proceedings (section 12-22.18), as to the discontinuance of liquidation proceedings (section 12-22.19), as to the provisions of the decree and its effect (section 12-22.20).

One of the principal problems arising under the provisions for corporate dissolution in the event of managerial deadlock is the question of the necessity for equitable grounds for dissolution other than the mere fact of deadlock itself. And one of the most significant questions in this general area is whether or not it is necessary to show either corporate insolvency or corporate paralysis before the dissolution will be granted.

Cases and law review articles which touch on this subject are numerous. Among the clearest is an Oregon decision, *Jackson v. Nicolai-Neppach Co.*⁸ Plaintiff, owner of fifty percent of the stock of a closed corporation, brought his ac-

7. S. C. CODE §12-22.15 (Supp. 1962).

8. 219 Ore. 560, 348 P. 2d 9 (1959).

tion alleging that the two owners of the remaining fifty percent had been arbitrarily oppressive and abusive in failing to pay larger dividends, etc., and that there was a managerial deadlock. Before trial, plaintiff moved to strike all claims of oppression and mismanagement, arguing that dissolution is mandatory by statute in the event of deadlock. The lower court dismissed the suit. On appeal, held: affirmed. The decision indicates that a solvent and prospering corporation can be dissolved in the event of a shareholder's deadlock only if the deadlock has caused a paralysis of the corporate function.

A case reaching the opposite conclusion is the Wisconsin case of *Strong v. Fromm Labs.*⁹ Here the mere showing that a vacancy in the board of directors could not be filled because of a shareholder deadlock was held sufficient under the Wisconsin statute to authorize dissolution. However, in this case it should be noted that the by-laws provided that the board could not function until the membership of the board was filled.¹⁰

In considering decisions from other states great care must be exercised in studying the exact language of the statutes, since the states have freely altered the language of the Model Act when adapting that act to their own needs. On this point, South Carolina is no exception. For example, in section 12-22.15(a) the language in sub-paragraph (1)(B) is all new; also sub-paragraph (3) is new in its entirety, as are sub-paragraphs (6) and (7). Likewise the provision of subsection (f) of section 12-22.15 is new, in providing that in an action by a shareholder "dissolution shall not be denied solely because it is found that the business of the corporation has been or could be conducted at a profit."

It is thus made clear that under the language of the South Carolina act, the widest possible discretion has been granted to the courts in dealing with dissolutions. Even so, it will still require a study of the decisions of our court to discover to what extent it will exercise its undoubted statutory power to dissolve solvent and prosperous corporations, or in fact to substitute its judgment for the judgment of corporate man-

9. 273 Wis. 159, 77 N. W. 2d 389 (1956).

10. This problem is also the subject of two interesting law review articles: 32 Rocky Mt. L. Rev. 406 (1960) and 45 Iowa L. Rev. 767 (1960).

agement under the provisions of section 12-22.23. That section, as it has been pointed out, directly authorizes the court to “make such order or grant such relief, other than dissolution, as in its discretion it deems appropriate, including, without limitation.” It then follows the authority to change the articles of incorporation; to cancel, alter or enjoin any resolution or other act of the corporation; to direct or prohibit “any act of the corporation”; or to provide for the purchase of shares from a shareholder. It is to be expected that the court will exercise this very sweeping statutory authority only in cases of extreme necessity and obvious hardship.