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The Winding up of a Corporation

LeRoy Noah French
Cornell Law School

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THE WINDING UP OF A CORPORATION

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THESIS

By ,

LeRoy Noah French,

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THE WINDING UP OF A CORPORATION.

There is a great diversity of judicial opinion as to the manner in which the affairs of a corporation may be brought to a close, and the existence of the corporation terminated. There are five ways which are commonly recognized by the courts for this purpose.

First, by forfeiture of the corporate franchise by the adjudication of a competent court.

Second, by the repeal of its charter under the reserved power of the state.

Third, by the voluntary surrender of the franchises by the stockholders.

Fourth, at the suit of the stockholders.

Fifth, the expiration of the time limited for its existence by the charter. But this latter is more properly treated under the head of 'ipso facto' forfeitures

The above classification will be of little importance without the further consideration of the different views with which the courts have regarded corporations to determine whether they come under any of these five methods. Then too we must study what are the effects of an act of the legislature upon the charter of the corporation, by which its existence is sought to be ended. To fully understand these effects, we must know what the nature of a charter is as regards the legislatures of the various states.

In the famous Dartmouth College Case, the United States Supreme Court ~~has~~ finally determined that a charter is a contract between the state and the shareholders of the corporation, and it cannot be altered by the state without the consent of the corporate body unless the right to alter has been expressly reserved to the state by the articles of incorporation. The learned Chief Justice Marshall, who delivered the opinion of the court, said: "The opinion of the court after mature deliberation is that this is a contract, the obligations of which cannot be impaired without violat-

ing the constitution of the United States" (Dartmouth College v Woodward, 4 Wheat, 518).

Where there is a reservation of the right to change or take away the charter by the legislature, then it may do so (People v O'Brion, 45 Hun 519; Erie R'y Co. v Casey, 26 Pa. St. 287; McLaren v Pennington, 1 Paige 102).

And where the legislature reserved the right to alter or repeal the charter on the happening of a condition, it has been held that the legislature has the power to decide whether that condition has happened or not, and the courts have nothing to say about it, in Chase v Babcock, 23 Pick, 334, the court said in the opinion: "We do not believe that the enquiry into the affairs or defaults of a corporation with a view to continue or discontinue it, is a judicial act". And the following cases held the same (Myrick v Brawley, 33 Minn. 377; Erie R'y Co. v Casey, supra;).

In Commonwealth v Lykens Water Co (110 Pa. St. 391) where the statute expressly stated that unless certain conditions such as constructing buildings etc., were performed within two years, that the franchises shall revert to the state, it was held that if the cor-

poration failed to perform the conditions, then the reverter takes place ipso facto upon the expiration of the two years.

We have seen in the cases already cited when the legislature can alter or repeal the charter of a corporation without the aid of any court, but there are cases where the legislature cannot do this, and the reason is because it would be depriving the corporation of property without due process of law which would be unconstitutional. In all the cases which hold that a corporation cannot be dissolved except by decree of the court, there was no express reservation in the charter of the corporation, so it is safe to say that the franchises of a corporation can be forfeited only by a judicial decision, unless it is expressly stated in the charter or enabling act that the legislature shall have the power so to do. (For authority see the following cases: *State v Noyes*, 47 Me. 189; *Buffett v Great Wes. Ry Co.* 25 Ill. 353; *Regents v Williams*, 31 Am. Dec. 72).

But the legislature always has the right to appoint a trustee to take its assets and administer them when a corporation has become dissolved in any way,

unless there is a statute restraining the legislature from doing so, and if the legislature does not appoint one, a court of equity will. In *Lathrop v Stedman*, (13 Blach. 134), the United States Circuit Court said: "The legislature has the right as an administrative measure, to appoint a trustee to take the assets and manage the affairs of a corporation whose charter has been repealed in conformity with the general just rules which it has prescribed, or with the rules of a court of equity if no statutory provisions have been enacted".

When the legislature grants certain franchises to a corporation upon a condition subsequent, namely, that the corporation shall do a certain act within a certain time, and the corporation fails to do it, whether such failure to perform causes a forfeiture of the franchises, ipso facto, is in much dispute. One class of cases hold that if franchises are given to a corporation on condition that they do certain acts within a certain time, and they fail to perform them, then the franchises are ipso facto forfeited, and that no judi-

cial act or any other is needed to complete the forfeiture.

Among the cases holding that a court of equity has no power to forfeit a charter of a corporation for non-performance of its conditions is *Elizabethtown Gaslight Co. v Greene*, (46 N. J. Eq. 118). The court held that a court of equity has no authority in virtue of its general jurisdiction to dissolve the corporation and deprive it of its franchises for non-user or misuser of its corporate powers, nor because it was not organized in strict accordance with the requirements of the statute by which it was created but in violation of them. In *National Docks R'y Co. v Central R'y Co.* (5 Eq. 755), Mr Justice Dixon said: "That an enquiry whether a corporation exists de jure or not is beyond the powers of the court of chancery and that whenever it is sought to impugn the legality of the corporation which exists under the forms of law, the remedy is by quo warranto or information in

the nature thereof instituted by the attorney general".

In *Brooklyn Steam Transit Co. v The City of Brooklyn* (78 N. Y. 524), the facts were as follows: The plaintiff was incorporated under the laws of New York State with authority to construct an underground and elevated railroad in the streets of Brooklyn, and the act provided that unless said company be organized and at least one mile of such railroad as it is authorized and empowered to construct under this act, be laid within three years thereafter, then and in that case, this act and all the powers, rights and franchises herein and hereby granted shall be deemed forfeited and terminated". About two years later another act was passed which extended the time for constructing the one mile of track to the 4th. day of July, 1876. From the time of its organization it kept an office and transacted business but it did not build or lay any portion of its railroad until June, 1878, when it built a mile of track outside of the City of Brooklyn and about the same time it commenced to lay down certain

foundations for an elevated railroad within the city limits, and it was prevented from proceeding further by the defendant. The defence was that the plaintiff lost its corporate existence by not building one mile of its road before the expiration of the time limited, to wit, July 4th., 1876. In this suit to restrain the defendants from interfering with the plaintiff in the construction of its road, the question to be decided is whether the plaintiff's corporate existence had been forfeited ipso facto in not constructing the one mile of road before July 4th. 1876, and the court held that upon the failure of the plaintiff to construct the one mile of road on or before July 4th., 1876, the corporation came to an end, as if that were the time limited in its charter for the corporate existence.

Among the cases which hold that the charter of a corporation is not forfeited ipso facto without some act of the state, is *Day et al v O. & L. C. R'y Co.*, (107 N. Y. 129). In this case they distinguish *Brooklyn Steam Transit Company v City of Brooklyn* (supra)

and hold that unless the act has an express provision to the effect that the charter will become void if certain acts are not done, that a non-compliance with the act will not work a forfeiture, and *Davis v Gray* (16 Wall. 203) lays down the same doctrine.

But from a study of the cases it seems that the weight of authority is that a corporation is not dissolved ipso facto for not complying with the conditions laid down in its charter, but that it is simply a cause of forfeiture which the state may take advantage of in a proceeding for that purpose, and the failure of the corporation to comply with the conditions must be judicially determined.

In *Bohaman v Binns* (31 Miss. 355) the rule was laid down that a corporation is regarded as in existence until a judgment of forfeiture has been pronounced in a proceeding of quo warranto, and that a person could not bring a suit on the ground that the corporation was dissolved because of a misuser or non-user, and the court while referring to the mis-user,

said: "This may be a good cause of forfeiture, and a court in a proper proceeding might declare a forfeiture of the franchises, but until such judgment shall be pronounced, the corporation must be regarded as still in existence".

But the legislature of a state has the right to pass a law authorizing private persons to forfeit charters by proceedings in a certain manner laid down by the statute, and Pennsylvania has a statute which authorizes any private citizen by a bill in equity to compel a corporation to show its authority to do a certain act. But in the case of the Western Pennsylvania Railroad Company's Appeal (104 Pa. St. 399) it was held that a private person could, by a bill in equity, compel a corporation to show its authority to do a particular act, but could not show the non-user of a franchise in order to establish a forfeiture of the charter of the corporation.

We have seen that as a general rule a forfeiture of the charter of a corporation can be accom-

plished only by some act of the state, and that in the absence of a statute otherwise providing, the rightful existence of the corporation is preserved for the purposes of every collateral proceeding.

And now we will discuss briefly, some of the grounds on which a state will forfeit a charter.

In reading the decisions of courts in actions brought to forfeit charters, it is seen that courts are reluctant to cause a forfeiture if they can help it, and this is especially true in corporations organized to carry on some public work.

In *Moore et al v the State*, (71 Ind. 493) the court said: "The rights, privileges and franchises of such corporations (in this case a Turnpike Company), we think, should not be declared forfeited, and they should not be ousted and excluded therefrom except for solid, weighty and cogent reasons, for the violation of a positive and prohibitory statute, and not of a statute whose provisions are permissions and apparently directory, and never upon merely technical grounds".

It seems that, as a general rule, a charter will not be forfeited unless the public has an interest in the act done or omitted, and the mis-user or non-user of the franchises was wilfull or intentional. (For authority for the above rule, see note in 22 Abb. New. Cases, 210; Denet v Taylor, 9 Cranch, 43; People vs N. R. S. R. Co., 121 N. Y. 182). In the last case Judge Finch, in giving the opinion, said: "It appears to be settled that the state as prosecutor must show on the part of the corporation accused some sin against the law of its being which has produced or tends to produce injury to the public. The transgression must not be merely formal or incidental, but material and serious, and such as to harm or menace the public's welfare".

Chapter II.

Ipso facto forfeiture of

Charter.

Under this head will be shown the manner in which a corporation may be dissolved other than by an act of the legislature or by a judgment of the court. When the charter of a corporation expresses a certain number of years of duration, and that time ends, the corporation is ipso facto dissolved, without any act of the state, and it has no right to do any more business as a corporation (People v Anderson etc., Valley Road Co., 76 Cal. 190; LeGrange etc., R. Co., v Rainey, 7 Cald. 420).

Some text writers lay down the rule that a corporation is dissolved by the death of all its members, but the cases do not appear to follow such a rule.

The weight of authority seems to be that the legal title in a corporation remains notwithstanding

the members change, and if all the members die at the same time, the stock of each member would pass to his representatives, and they would have authority to carry on the business of the corporation, and there would be no dissolution. (Russell v McLellan, 14 Pick. 63).

Chapter III.

Voluntary Dissolution.

Where a corporation which owes some duty to the public, surrenders its franchises, there must be an acceptance of them by the state, or there will be no dissolution, because a charter is a contract and there must be the same kind of an agreement by the parties to dissolve as there was to form the contract (The Boston Glass Mfg. Co., v Langdon, 24 Pick, 49).

But according to the modern decision, there need be no acceptance by the state in private corporations although the old decisions held the contrary, and the reason for it was because a dissolution extinguished the debts of the corporation, and it would be a bad rule to allow a corporation, when it became heavily indebted, to surrender its franchises, and in that way get out of paying its just debts. But now it is a well

settled rule that dissolution does not extinguish the debts of a corporation, and so that old reason why a state should accept the surrender of a charter, is done away with, and now a strictly private corporation may surrender its franchises and dissolve the corporation without an acceptance by the state (Slee v Bloom, 19 Johns. 456; McMann v Morrison, 79 Am. Dec. 418).

We have just considered the voluntary dissolution of a corporation by a surrender of its franchises and found that in a private corporation its franchises may be surrendered without an acceptance by the state. We will next consider what amounts to a surrender of its franchises.

Of course a formal act of the corporation declaring a surrender and an acceptance of it by the state, will always effect a dissolution, but it has been held that other acts not amounting to a formal surrender, were evidence of a surrender and dissolved the corporation. In the State v Vincennes University, 5 Ind. 77, the court held that if a corporation ne-

glects for a long time to exercise its franchises, a presumption of surrender arises, but this may be rebutted, and was in this case. The same rule was laid down in *Union Agricultural Society v Gamble*, (52 Iowa, 524).

It is substantially correct to say that when a charter is granted to a body of men for the purpose of organizing a corporation, and they neglect to accept it within a reasonable time, it is evidence of a surrender, and the franchises cannot be renewed without a new expression of the will of the legislature. (*The State v Bull*, 16 Conn. 179).

We will next discuss whether a corporation may be dissolved by vote of the majority of its shareholders, or whether there must be a unanimous vote. There is a conflict of law on this question, some courts holding that a corporation may be dissolved by a majority vote, while others hold that there must be a unanimous vote. In *Polar Star Lodge, No. 1 vs Polar Star Lodge, No. 2*, (16 La. An. 53), the facts were as

follows: Plaintiff Lodge No. 1 was organized and was carried on in the State of Louisiana for quite a considerable time, but at one of their meetings a majority of the members voted to surrender their charter against the wishes of the minority, and the charter was subsequently surrendered, and the seceding majority formed Lodge No. 2 and transferred the property of Lodge No. 1 to the new lodge. Now the plaintiffs, who were the minority of Lodge No. 1, bring this suit to have their charter given back to them so they can get possession of the property of the Lodge which had been transferred to Lodge No. 2, and it was held that the transfer was void and that Lodge No. 1 could recover its property. The court in the opinion said: "There is no doubt of the right of individual members to withdraw themselves from the lodge. And doubtless the whole of the members might do the same thing by their unanimous resolution. But so long as a sufficient number of members to represent and continue the corporation, exist, it does not appear to us to be within the power of the majority to

dissolve the corporation. They may dissolve their own connection with it, but they cannot prejudice the vested rights of their co-corporators by any act foreign to the objects of the corporation". Revere vs The Boston Copper Company (15 Pick. 351) held the same as the above case. In this case the plaintiff contracted with the corporation to do certain work during the time for which the corporation was established. Subsequently by a majority vote, the directors were authorized to sell the property and wind up the business which they did, and they discharged the plaintiff. The plaintiff brings this action to recover damages for the discharge, claiming that the corporation was not dissolved by a majority vote, and that it is still liable on the contract until it is legally dissolved. The court held that there must be a unanimous vote in order to dissolve, and in this case there was not a dissolution, and therefore the corporation was liable to the plaintiff.

Among the other class of cases which hold

that a corporation may be dissolved by a majority vote of the shareholders, is *Treadwell v Salisbury Mfg. Co.*, 7 Gray, 393, which was a case where a majority of the shareholders voted to wind up the corporation and sell the corporate property. The minority brought a suit in equity to restrain them from selling the property, but the court held that a corporation established for trading and manufacturing purposes, has the right, if it is deemed expedient by a majority of the stockholders, to wind up the affairs and close the business. There are many exceptions to this latter rule owing to the purposes for which some corporations are created, and in which they owe some duty to the public, such as railway, canal and turnpike corporations, but in a private corporation, created for trading purposes, the better rule seems to be that a majority of the shareholders may, by vote, dissolve the corporation.

Chapter IV.

Winding up at the Suit of Stockholders.

A corporation may be wound up by a suit brought by shareholders. Many of the states have statutes which regulate this kind of proceeding. In West Virginia, there is a statute which enables a majority of the shareholders of a corporation to wind up the business, but in *Hurst v Coe*, (30 W. Va. 158), the rule is laid down that although it is competent for a majority in interest of the shareholders to discontinue the business of the corporation, yet a statutory proceeding for dissolution cannot be had at the instance of a majority without a showing of good cause therefor. But in *Ogilvie v Attrill* (105 U. S. 605) a rule was laid down which is directly opposite to the one just stated, and Mr. Justice Field said in the opinion, that the court will not examine into the affairs of the corporation to determine the expediency of its action, or

the motives for it, when the action itself is lawful.

But a corporation will not be dissolved at the suit of a single stockholder simply because the officers of the corporation have refused to let the shareholder inspect its books, and that it is carrying on a losing business. In a recent case in England, it was held that where a corporation was established for the purpose of carrying on a banking business, and then abandoned that business and went into land speculation, ^{which were} ~~that was~~ ultra vires, the shareholders need not bring an action to restrain the corporation from doing it, but may bring an action to wind up the corporation. (Re 'Crown Bank, 44 Ch. D. 634).

In many of our states there are statutes which enable a court of equity to wind up a corporation at the suit of a stockholder, but as a general rule, unless a statute has given a court of equity this power, it has no jurisdiction to dissolve the corporation during its life, but this statement is not to be confused with the jurisdiction of a court of equity to appoint a receiver and close up the business of a corporation

when its charter has expired, or when it has forfeited its franchises by reason of non-user, but no final settlement between a corporation and its members on the closing up of its business is valid as against creditors unless they are parties to the proceeding.

Chapter V.

The Effects of a Dissolution.

We have seen the ways in which a corporation may be dissolved and the business wound up, and now we will consider what the effects of a dissolution is upon the corporation, and on persons who are connected with it in any way. We will first see how the dissolution of a corporation was treated at common law.

At common law the effect of a dissolution was to put an end to its existence for all purposes. It could not sue, neither could it be sued, and all actions by or against it abated, and all the real property belonging to the corporation went to the grantors and the personal property went to the state. But now, since equity has come in, the property does not revert to the state but is held as a trust fund for the benefit of the creditors and shareholders. After a corporation is dissolved it has no power to make contracts

which will bind its assets, but the corporation in such a case must be dissolved de jure and not merely de facto. In regard to its capacity to sue after dissolution, it has no power to sue in its corporate name, but at present equity will appoint a trustee to collect all debts owing to it, and such money, when collected, will go to the creditors of the corporation if there are any. In the modern law equity regards all assets and claims of the corporation as a trust fund for the benefit of the creditor, and it is a well settled rule that equity will not see a trust fail for want of a trustee, so the court will appoint a receiver to settle up all the affairs of the corporation, and although a corporation cannot be sued after dissolution, and all actions against it abate, yet equity will compel the assignee to distribute all its assets among the creditors according to their just claims.

The above rule does not apply where there is a statute which authorizes a continuation of the suit already begun against the corporation in the corporate

name. From the above doctrine it necessarily follows that in the absence of a saving statute, any attachment which has been levied upon property, and the attachment suit has not yet come to judgment, will be abated by a dissolution of the corporation, and it has been held at common law that if a corporation was dissolved after it had obtained judgment, it could not issue execution on the judgment in its own name (May v State Bank of N. C. 40 A. Dec. 726). At common law if a corporation was dissolved, debts owing to it were extinguished, and a stockholder was not liable to pay calls on the shares for which he had subscribed.

We have seen what the effects at common law were upon a corporation when it became dissolved. Now we will consider some of the changes which have come about in the modern decisions on this subject. At present the obligations of the corporation survive against its assets, and instead of allowing a corporation to get away from its obligations when it is dissolved, as at common law, it holds its assets for the payment of its debts as has already been stated, by means of

trustees appointed by a court of equity, and all the assets are considered a trust fund for the benefit of the creditors and shareholders, so by this doctrine, a corporation cannot by dissolving itself, defeat the rights of its creditors because the corporation will be considered to be in existence for them to recover their claims, and in many of the states there are statutes which continue corporations for the purpose of suing or being sued for a certain period beyond the time of dissolution.

With respect to the effect of dissolution on an executory contract, of course a dissolution will relieve the corporation from any further liability, but it will be liable for the damage incurred in the breach of contract. Some writers lay down the rule that a statute authorizing the corporation to surrender its charter, and be dissolved, is infringing the obligations of the contract subsisting between the corporation and third persons, but this is not the case, because a person who contracts with a corporation is supposed to know the liability of the corporation, and his rights against

it upon its dissolution. (People v O'Brion, 111 N. Y. 1).

As to when the dissolution of a corporation takes effect: in Crease v Babcock (23 Pick. 334) the rule is laid down that when the legislature repeals a charter the corporation is dissolved as soon as the act takes effect. When a corporation is dissolved by court, the dissolution takes effect as soon as the decree of dissolution has been entered.

Le Roy H. French.