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INVOLUNTARY DISSOLUTION AS A REMEDY FOR FREEZE-OUTS OF MINORITY SHAREHOLDERS: TWO WEST VIRGINIA STATUTES

D. CHRISTOPHER WELLS*

I. INTRODUCTION

A. The Illiquidity Vise

In 1893, Judge John Doyle, then the president of the Ohio State Bar Association, addressed his colleagues on the problem of majority shareholder “squeeze outs” of minority shareholders. His speech highlighted the “old story, so often told of a prominent Eastern newspaperman’s reply to the question of what the shares in his company were worth. . . . ‘There are 51 shares,’ said he, ‘that are worth $250,000. There are 49 shares that are not worth a ____.’” The passage of nearly a century has not diminished the anecdote’s central truth: minority shareholders of close corporations, unlike those of publicly held corporations,
are often squeezed in a vise of illiquidity. The fixed jaw of the vise is the absence of any broad market and thus the absence of market value for their shares. But the problem of market illiquidity is one that many minority shareholders understand and accept prior to going into the business. They accept that constraint because they expect what might be termed "intracorporate liquidity"—that their initial investment will ensure a regular, sufficient income and that their fellow shareholders or the corporation will repurchase their shares if the need should arise. It is the frustration of this expectation that forms the opposing jaw of the vise: the minority shareholder's corporate family acts to freeze him out, denying the expected intra-corporate liquidity that prompted his initial investment.

Like all shares issued by a corporation, minority shares represent value contributed to and existing in the corporation, no matter whether the company is solvent or in liquidation. Without the cooperation of the majority, however, the value of this investment and any subsequent return remain captive in the corporation. It is the majority who retain the power to decide when and if the corporation will declare dividends, redeem shares, employ the minority, partially or completely liquidate, or provide the minority with some intracorporate return on the value of their shares. Where majority shareholders preclude such return and hold minority interests captive, not only do they prevent intracorporate returns, but they also eliminate any chance of sale to outsiders. No rational investor would buy the minority's ills.

This article describes one method of escape from the minority shareholder illiquidity vise—involuntary judicial liquidation and dissolution of the corporation—and the two West Virginia statutes that hold the promise of such an escape. The article intends to provide some help for minority shareholders who desire both to: 1) break cleanly from their corporation and 2) to take their investments with them. To that end, its intermediate goals are several. First, it attempts to heighten general awareness of the freeze-out phenomenon, in order to promote action, by negotiation or contract, before damage is incurred by the corporation or the shareholders.

The occasional use of the masculine pronoun in the article, is for convenience only where the use of two pronouns or the plural pronoun is not felicitous. Of course, freeze-outs know no sexual boundaries.

Many of the problems that lead to squeeze-outs and the oppression of minority interests can be anticipated and avoided by agreement and by the choice of organizational methods at the outset of the enterprise. A discussion of such prophylactic measures is beyond the scope of this article. For some helpful suggestions along those lines, see, O'Neal, supra note 1, at 547-74.
Second, it hopes to assure those minority shareholders without internal corporate protections that they are not without recourse against freeze-out tactics employed by the controlling shareholders, even where their minority interests are quite small. Finally, it serves to caution those who advise controlling shareholders that oppressive tactics may not only be improper, but ultimately unsuccessful and quite costly.

B. The Freeze-Out and Illiquidity Paradigm

The freeze-out and illiquidity problem often arises in the following manner. A joins with B and C to form ABC corporation. A, B, and C invest most of their respective net worths in ABC, expecting to receive a reasonable return in the form of corporate employment, benefits, distributions, and, upon their retirement, to have their shares repurchased by the corporation or other shareholders. Sometime after formation, B and C use their aggregate majority power to exclude A from management and employment; they refuse to make any corporate distributions, and they decline to repurchase A's stock for fair value. In short, they freeze A out. Unfortunately for A, his expectations of income and buy-out were not reduced to an enforceable writing or otherwise made a matter of right, consequently A is left with no current return on his investment. No less devastating is the fact that A's investment remains captive in the corporation with no corporate mechanism to effect its rescue. In such cases, A's only feasible recourse may be to the courts.7

Had A, B, and C organized as a general partnership, A would have the statutory alternative of unilaterally forcing dissolution and liquidation of the business, which would result in a clean break, personally and economically, from B and C.8 Most important, it would allow A to retrieve his captive investment, as appreciated or depreciated, after the liquidation of the business. The crucial question facing A is whether ABC's choice of the corporate form over the partnership form has precluded the judicial remedy of dissolution. In West Virginia, as in most states, it has not; minority shareholders do have the right to seek involuntary dissolution and liquidation of their corporation under either or both of two statutory alternatives. But, as we shall see, the hurdles to corporate dissolution are set a good deal higher than those for general partnership.

C. A Brief History of the Statutes

In 1868, West Virginia joined the vanguard of states providing a remedy of

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7 Depending on the particular circumstances, A might sue in contract, alleging an enforceable oral agreement or expectancy regarding, for example, dividends or employment. Success would presumably result in the awarding of such contract damages as past wages or dividends and perhaps specific performance, such as reinstatement of employment. Even if successful in litigation, A might remain an uncomfortable shareholder in a hostile corporation. In addition, A might sue in tort, alleging fraud or breach of fiduciary duty by the majority. Success on these tort theories would normally mean that A would be allowed to recover compensatory and perhaps punitive damages; he might also be granted an injunction restoring him to his previous status in the corporation. In this situation, also, A would likely still remain tied to the corporation as a shareholder.

8 See W. VA. CODE §§ 47-8A-29 to 47-8A-36 (West Virginia Uniform Partnership Act).
dissolution for minority shareholders by adopting one of the first statutes to grant equity courts the power to wind up and dissolve corporations at the request of minority interests. In its original form, the statute required both a jurisdictional minimum of "one-third interest of the stockholders" seeking dissolution and a showing of "sufficient cause" for winding up and dissolving the corporation. This statute, with the addition of some procedural provisions and the lowering of its jurisdictional threshold to one-fifth interest, exists now as section 134 of the current West Virginia Corporation Act. In 1974 West Virginia adopted in substantial part the Model Business Corporation Act. The new West Virginia Corporation Act not only retained the older statute, section 134, but also added another arrow to the minority shareholder's quiver, section 41. Like section 134, section 41 allows minority shareholders to sue for liquidation and dissolution of their corporations. Unlike the older statute however, section 41 imposes no minimum interest to obtain the court's jurisdiction. That is, any shareholder may sue for dissolution no matter how small his or her ownership interest. In addition, section 41 sets forth more specific and arguably more liberal grounds for involuntary dissolution.

Subsequent to the adoption of section 41, in a case brought under the pre-

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9 W. VA. CODE (1868) ch. 53 § 57, at 403, provides:

Proceedings in equity to dissolve a corporation

57. If not less than one-third in interest of the stockholders of a corporation desire to wind up its affairs, they may apply by bill in chancery to the circuit court of the county in which the principal office or place of business of such corporation is situated, or if there be no such office or place of business in this state, to the circuit court of the county in which the other stockholders, or any one or more of them reside, or are found, or in which the property of such corporation or any part of it may be, setting forth in the bill the grounds of their application; and the court may thereupon proceed according to the principles and usages of equity to hear the matter, and if sufficient cause therefor be shown, to decree a dissolution of the corporation, and make such orders and decrees and award such injunctions in the cause as justice and equity may require.


10 W. VA. CODE (1868) ch. 53, § 57 at 403.

11 W. VA. CODE § 31-1-134 (1984) [hereinafter cited as "section 134"] See infra note 43 for the full text of the statute. See text accompanying footnotes 43 through 80 for a discussion of the interpretation and application of section 134.


13 W. VA. CODE § 31-1-41 (1982) [hereinafter cited as "section 41"]'). For a discussion of the interpretation and application of section 41, see infra text accompanying footnotes 81 through 143.

14 Id.
cursor to section 134, the West Virginia Supreme Court emphasized that the frozen-out minority shareholder is not limited to seeking complete dissolution. In deciding *Masinter v. WEBCO Co.*, the court recognized that minority shareholders have the right to sue in equity when their reasonable expectations as shareholders have been frustrated by the majority. When such situations occur, West Virginia courts are free to fashion remedies less drastic than dissolution if the facts call for an end to the freeze-out or minority oppression, but not to the corporation itself.

II. COMMON FREEZE-OUT TECHNIQUES

To understand the nature and scope of the freeze-out and oppression phenomenon, it is helpful to examine some of the corporate maneuvers designed to impair minority shareholder claims to corporate income, claims to corporate assets upon liquidation, and claims to voting and control rights. The range and number of such maneuvers are limited only by the imaginations of controlling shareholders and their advisors, which the following examples illustrate.

Modern corporation statutes, including the West Virginia Corporation Act, express a philosophical preference for flexibility and efficiency of corporate action, two attributes thought to be essential for successful competition. A principal embodiment of that philosophy is the rule that the majority of shareholders control the corporation. Whereas common law imposed a requirement of unanimous shareholder approval of significant corporate action such as mergers and structural changes, many modern corporations statutes allow such fundamental changes with the approval of only a bare majority of shareholders. Although the elimination of unanimity requirements may enhance the efficiency and speed of corporate actions, such statutes correspondingly impair the effective veto power of minority interests who might oppose such corporate action.

Thus, a significant concomitant of the modern rule of flexibility and efficiency

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15 *Masinter*, 262 S.E.2d 433. The case was actually brought under W. Va. Code § 31-1-81 (1931), prior to adoption of the new West Virginia Corporation Act.

16 *Id. See also* Meiselman v. Meiselman, 307 S.E.2d 551 (N.C. 1983) (Martin, J., concurring) (interpreting *Masinter* as a “reasonable expectations” case).

17 *See Voeller v. Neilton Warehouse Co.*, 311 U.S. 531, 535 n.6 (1941) (dictum); Lattin, *Minority and Dissenting Shareholder’s Rights in Fundamental Changes*, 23 LAW AND CONTEMPT. PROB. 307, 310 (1958); *Note, supra note 1.*


19 This is not to say that shareholders who dissent from fundamental corporate changes are utterly without remedy. In the case of mergers, consolidations, and the sale or exchange of substantially all corporate assets, any shareholder may dissent and receive fair value for some or all of his shares in the corporation. W. Va. Code §§ 31-1-122 to 123 (1982). However, in so doing the shareholder may be acquiescing in a complete squeeze-out.
is a shift in the balance of power in the corporation even more toward the majority. In the past, the majority's desires could be stymied by a veto of a small minority. Now, the majority may reign effectively unhindered by structural and voting requirements. When, as is often the case in the closely held corporation, the majority block is a static group, it may take unfair advantage of this dominance to consolidate its position and freeze out the minority. Such freeze-outs may attack any or all of the categories of shareholder rights and interests.

Shareholder rights and interests fall naturally into three general categories. The first category includes the shareholders' claims upon distributions of corporate assets and income while the corporation is a going concern. Such claims may be to dividends, to the compensation and benefits attendant to employment with the corporation, to the right to sell shares back to the corporation or to other shareholders, or to a combination of any of these. Whatever form such distributions take, close corporation shareholders typically rely heavily on them as a principal source of income.

A second category of shareholder rights and interests includes claims to a reasonable share of the corporate assets upon the sale or liquidation of the corporation. These claims are usually directly proportional to the shareholder's percentage of share ownership. Absent a buy-out agreement or the equivalent, this claim may be the shareholder's only means of recovering his initial capital investment. With this fact in mind, minority shareholders may see the involuntary dissolution and liquidation of the close corporation as the only appropriate remedy to rescue assets held captive by the majority.

The third category of shareholder rights and interests relates to the shareholders' participation in the management of the enterprise. The right to such participation may derive both from the minority shareholders' ownership of shares and from their management positions within the corporation. It may also derive, in the day-to-day sense, from other employment with the corporation. Again, the extent and effectiveness of such shareholder participation, absent agreement by contract or comity, is usually proportional to stock ownership and the relative power such ownership yields.

A. Reduction or Elimination of Minority Shareholder Claims Upon Corporate Income and Assets

With respect to the shareholder claims upon corporate income and assets while

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21 A "buy-out" agreement is an arrangement under which the stock of a shareholder who dies, retires, becomes disabled, or otherwise ceases participation in the corporation is purchased by the corporation (a stock-purchase agreement) or by the other shareholder (a buy-sell agreement). See 2 F. O'NEAL, CLOSE CORPORATIONS, §§ 7.01 (1971). For discussion of a proposed statutorily imposed buy-out right for minority shareholders, see Hetherington & Dooley, supra note 9, at 50-62.
the business is a going concern, controlling shareholders often disadvantage the minority by refusing to declare dividends or to make other distributions despite the existence of sufficient corporate assets to pay such distributions. 22 Although a refusal to pay dividends must apply also to the majority's shares of the same class, the majority may employ other means to derive return from the corporation, such as salaries, bonuses, low-interest loans, retirement plans, and other benefits of employment with the company.

This suggests a second common tactic for depriving the minority of the benefits of corporate income. Majority shareholders may exclude the minority from employment with the corporation, thus denying them the compensation and benefits available to the majority. 23 This tactic can be especially devastating for minority shareholders. Initially, many minority shareholders decide to invest in the close corporation solely because of what they perceive to be a guarantee of employment. 24 It is the promise of employment, not the promise of dividends, that provides investment bait. 25 In addition, minority shareholders' investments in the close corporation often represent the bulk of their personal assets. 26 Therefore, where the majority deprives the minority of employment, refuses to pay dividends, and refuses to purchase their stock or to liquidate the corporation, the majority have positioned themselves to be able to utilize the minority's capital at no cost and to benefit exclusively from the return on capital.

The majority may exacerbate the effect of such tactics by appropriating to themselves the earnings attributable to the minority's capital. This may be accomplished by paying to themselves excessive salaries, taking undeserved bonuses and benefits, 27 and using the assets and property of the corporation exclusively for personal benefit. 28 When corporations are unprofitable, simply keeping a mori-

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22 E.g., White v. Perkins, 213 Va. 129, 189 S.E.2d 315 (1972); Tweel v. Frankel, 444 F. Supp. 1071 (S.D. W. Va. 1978); Gray v. Hall, 10 Ill. App. 3d 1030, 295 N.E.2d 506 (1973) (dictum). This does not suggest that refusal to pay dividends is in all cases an oppressive tactic. It is quite common for close corporations to provide investment return in other ways. See infra text accompanying notes 20-21.
25 Hallahan v. Halton Corp., 7 Mass. App. Ct. 68, 69, 385 N.E.2d 1033, 1034 (1979) ("An investor in a close corporation typically depends on this salary as the principal return on his investment, since the 'earnings of close corporation . . . are distributed in major part in salaries, bonuses and retirement benefits.'"') (quoting O'NEAL, supra note 4, at § 1.07).
26 Id.; Galler v. Galler, 32 Ill. 2d 16, 27, 203 N.E.2d 577, 586 (1965).
27 E.g., Mulder v. Mittelstadt, 120 Wis. 2d 103, 352 N.W.2d 223 (1984); Tweel, 444 F. Supp. 1071. See Gray, 10 Ill. App. 3d 1030, 295 N.E.2d 506 (conduct oppressive where dividends are precluded by large salaries paid to officers who are majority shareholders) (dictum).
bund corporation alive can be detrimental to the minority, even where the majority compensation and benefits are not especially excessive. The corporation then becomes a device merely to perpetuate the majority's jobs and income.\textsuperscript{29}

Whatever forms they take, all such tactics have in common the goal of appropriating income and benefits exclusively to the majority. Frozen-out shareholders see their investments tied up in the corporate balance sheet and have no corporate mechanism to force a return on their investments, whether by employment compensation, distributions, or otherwise.

B. Reduction or Elimination of Minority Shareholder Claims on Corporate Assets Upon Liquidation

Even where the majority intends completely or partially to liquidate the corporation—action that would normally provide the promise of releasing minority investment—they may act beforehand to reduce the minority shareholders' ultimate claims. Such action may focus on reducing the minority's proportional claims to liquidation distributions, or the seniority of such claims, or both. For example, the majority may see to it that their own infusions of capital are largely in the form of debt and the minority's are in the form of equity. They may also arrange to swap equity securities for debt securities. In either case, their intent is to take advantage of the liquidation preference available to debt securities over equity securities. They may achieve the same end by issuing preferred shares to themselves and common stock to the minority. So long as they do not disrupt their control status and voting power, any of these methods may provide the desired liquidation preference over the minority.

Where minority shareholders are reluctant to invest new capital, as one might expect in situations where the minority has little control or has had a falling out with active management, the majority may decide to issue more shares to themselves, often for consideration below fair value.\textsuperscript{30} In that way, the majority gains a great deal of proportional advantage for relatively little added investment. In the most egregious cases, the net effect on the minority will be to reduce their liquidation claims to almost nothing.\textsuperscript{31}

Controlling shareholders may also transfer the assets of the corporation to another corporation owned wholly by themselves, either for consideration less than fair value or for the non-voting stock of the second corporation.\textsuperscript{32} In either case, they reduce the minority shareholders' liquidation expectation.

\textsuperscript{29} E.g., Kruger v. Gerth, 16 N.Y.2d 802, 1 N.E.2d 355, 263 N.Y.S.2d 210, (1965); Central Standard Life Ins. Co. v. Davis, 10 Ill. 2d 566, 141 N.E.2d 45 (1957).


\textsuperscript{31} See, e.g., Hyman, 342 Ill. App. 489, 97 N.E.2d 122 (outside shareholder given choice of investing additional $136,000 or watching proportional interest drop from 20% to less than 1%).

\textsuperscript{32} See Note, supra note 1, at 1630-31; Note, The Right of Shareholders Dissenting From Corporate Combinations to Demand Cash Payment for their Shares, 72 HARV L. REV. 1132 (1959).
Perhaps the simplest method of frustrating the minority's liquidation expectancy is for the majority simply to waste corporate assets or to spend them in ways benefitting only themselves prior to liquidation. This can be accomplished by transferring corporate property to themselves at fire-sale prices, awarding themselves handsome bonuses, or in various other fashions.

Whether by securities manipulation, fraud, or rather straightforward business transactions, the majority will often have mechanisms available for gaining liquidation advantage over the minority. All such mechanisms may oppress the minority by frustrating their reasonable expectations of return upon liquidation.

C. Reduction or Elimination of the Participation and Control Rights of the Minority Shareholders

Minority shareholders typically will have some right to participate at least indirectly in the management and control of the corporation, usually in rough proportion to their relative share ownership. This right to participate, particularly in the selection and supervision of management, is enhanced and protected by state corporation laws, the corporate charter, and the by-laws through cumulative voting, preemptive rights, and rights of access to corporate books and records. Controlling shareholders can, however, dilute such minority participation both by frontal and flank attacks.

For example, majority shareholders may vote to eliminate provisions for cumulative voting, resulting in straight voting in the election of directors. That has the effect of making every director a “majority” director and denying minority interests any representation on the board. The West Virginia Corporation Act requires cumulative voting for West Virginia corporations, apparently to protect against just such corporate maneuvers. But even in the face of statutorily or constitutionally mandated cumulative voting, majority shareholders may employ other, apparently legal means to frustrate its purpose. A classic tactic is to stagger (or classify) the board of directors so that only one-half or one-third of the board is elected each year. With fewer directors standing for election each year, the share ownership threshold that would guarantee election of at least one director increases. In that way, any level of minority interest will have a reduced right to representa-

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14 See W. Va. Code §§ 31-1-93, -90, -105 (1984), which relate to cumulative voting, preemptive rights, and access to books and records of the corporation, respectively.
16 For example, under cumulative voting, with a board of nine directors, a shareholder with 10% + 1 voting shares will be assured of electing one of the nine directors. Classifying the board so as the elect only three of the nine directors in a given year will mean a shareholder (or group) would need 25% + 1 voting shares to elect one of the three. Because this will be repeated at each annual election, the threshold to elect one director jumps to over 25%. See generally W. Va. Code § 31-1-21 regarding classification and other changes in the size and makeup of the board.
tion on the board. Majority shareholders can achieve the same result even more directly by reducing the size of the board itself—even to a single director.37

Another means for reducing minority participation is to increase the relative holdings of the majority. Where the board decides to issue more voting stock, whether or not preemptive rights exist, minority shareholders who are unhappy with current management by the controlling shareholders are likely to decline to purchase from the new issuance. Understandably, they will often be loath to throw good money after bad for any reason, particularly just to preserve their proportional level of minority interest.38 Confronted with a Hobson's choice, they will refuse to contribute additional capital, resigned to seeing their already ineffective voting power further diluted.

In addition to the maneuvers described above, which on their face are often entirely legal, the majority may also resort to deception and subterfuge to reduce the effectiveness, if not the actual level, of minority shareholder participation in corporate management. One such deception is to withhold from minority shareholders or minority directors the facts and information crucial to corporate decisionmaking.39 Whether misled or simply uninformed, minority voters may not understand the significance of issues important to their positions and investments. Another type of deception is simply to fail to hold meetings of the shareholders or board. In that way, corporate decisions are made by the majority as managing officers, pre-empting any minority voice in corporate affairs. A similar but less obvious device, and one harder to combat, is to hold "pre-meetings" of select shareholder or director groups so as to control the agenda or even to decide crucial questions ahead of the formal meetings. In the formal meeting the minority participants then face what are actually faits accomplis.

D. Reduction or Elimination of Minority Shareholder Rights and Interests by Merger or the Sale of Corporate Assets

Perhaps the most effective means for the controlling parties of the corporation to freeze-out and even completely squeeze-out minority shareholders is by a merger of the corporation or a sale of substantially all its assets.40 Such a strategy will commonly have a deleterious effect on all three categories of shareholder rights. For example, in the event of a sale of the corporate assets to a second corporation, minority shareholders might retain their stock. However, they will have no voice, since their "old" corporation will probably now be only a shell corporation which owns nothing but the stock of the "new" corporation. This situation leaves them

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37 W. VA. CODE § 31-1-21 (1984) allows boards with one director.
40 See generally Note, supra note 1 at 1630-34; O'Neal, supra note 1 at 254-87.
with no rights except to the dividends that may accrue to their own corporation from the profits made by the second. Because the new corporation is controlled exclusively by the former majority shareholders of the old corporation, there is no realistic prospect of economic return to the minority.

Another permutation of this approach is to allow the minority shareholders the opportunity to exchange their stock for stock in the new corporation. Where the intent of the merger is to freeze the minority out, it is almost a certainty that their new stock will have neither substantial voting rights nor significant rights to distributions. In such situations, many minority shareholders might look longingly upon a cash-out merger, where they would be forced to sell their corporate stock for cash. In cash-out mergers, minority shareholders receive at least some consideration for their lost interests, and in the event they believe the compensation inadequate, they have appraisal rights.41

III. STATUTORY ALTERNATIVES FOR RELIEF BY LIQUIDATION AND DISSOLUTION

The ultimate goal of all freeze-out tactics is to have the minority cede all ownership rights in the corporation to the majority. In order to liquidate their interests, the minority will be forced to sell their shares to the majority or back to the corporation at a price well below any fair value.42 Because minority shareholders have no market alternative and no adequate structural safeguards to force immediate fair treatment by the corporation and those who control it, they will all too often accept reduced value for their stock and be all too happy that they got something, however inadequate, in return. But West Virginia provides such minority shareholders two statutory alternatives to suffering a freeze-out. As will be shown, one such statutory alternative, suit under section 134, presents standing and interpretive hurdles. Those hurdles are sufficiently substantial to render section 134's relief unavailable to many minority shareholders. The second statutory alternative, suit under section 41, takes a more modern approach by eliminating the standing problems and specifying numerous, arguably more liberal, grounds for dissolution. Although at yet only sparsely interpreted, section 41 appears to provide minority shareholders a workable escape from, or at least a loosening of, the jaws of the illiquidity vise.

A. Involuntary Dissolution Pursuant to Section 31-1-134

Section 13443 provides that shareholders with at least "one fifth in interest"

43 W. Va. Code § 31-1-134 (1984) provides as follows: Actions for dissolution by shareholders; right of majority shareholders to purchase plaintiff's shares; appeal. If not less than one fifth in interest of the shareholders of a corporation desire to wind up its affairs, they may apply by complaint to the circuit court of the country
in a West Virginia corporation may petition the circuit court in specified venues for the involuntary dissolution of that corporation. If the petitioning shareholders show "sufficient cause," the court may order the corporation to be dissolved and may grant other injunctive relief as necessary. To avoid dissolution, the majority shareholders may purchase the minority shares for "fair cash value." Where the parties are unable to agree on the fair value, the minority has an appraisal right, the procedure which is set forth in the statute. Both sides have the right of appeal to the West Virginia Supreme Court of Appeals.

Though the statute itself does not expressly limit its application to domestic corporations, such a limitation may be inferred both from the definitional sections and structure of the West Virginia Corporation Act and from the nature of dissolution. W. VA. CODE § 31-1-6(f) (1984) defines "corporation" to mean non-foreign corporations, at least with respect to Parts I and II of the Corporation Act. Though that definition does not by its terms carry over to Part III, in which section 134 is found, Part II rather clearly addresses only matters of corporate structure and organization for domestic corporations. See W. VA. CODE §§ 31-1-77-135 (1984). Conceptually, it can be seen that dissolution is the formal cessation of the corporation with the consent of the state that granted its charter. In the case of a foreign corporation, the procedure is termed "revocation" of its certificate of authority to do business in the state, not "dissolution." See, e.g., W. VA. CODE §§ 31-1-53 through -56b, and 31-1-62 and -63 (1984). See also Hetherington and Dooley, supra note 9, at 8 n.14.
As noted above, the present section 134 and its predecessors have been with us, under other names and with occasional revisions, since 1868. Despite the longevity of the statute, there are relatively few reported cases decided under it and even fewer cases that address significant issues of statutory interpretation. The scarcity of reported cases may be attributed to the reluctance of minority shareholders to resort to judicial assistance in solving their problems and to the relative novelty of close corporations in earlier times. The lack of statutory interpretation in the few existing cases may be due in large part to an apparent clarity in the requirements and language of the statute. With respect to at least two crucial issues, however, the section 134 is not as clear as it superficially appears. The statute does not define "one fifth in interest" or indicate how this minimum interest is to be measured. Nor does the statute suggest what might constitute "sufficient cause" to warrant dissolution. As will be seen, the problems inherent in those two issues when coupled with the availability of a more progressive statutory approach in section 41 may render section 134 of little modern consequence.

1. The Minimum Interest Requirement of Section 134

Section 134 makes judicial dissolution available only to shareholders who hold in aggregate "not less than one fifth in interest" in the corporation. The burden of proof on the minimum interest issue falls upon the shareholders seeking dissolution, and failure to allege and prove the requisite interest will result in dismissal. The statute, however, is unclear as to how the shareholders' interests are to be measured, and no reported case addresses this issue directly. An obvious resolution, and the probable assumption of the drafters, is that, at least in the case of corporations with but one class of outstanding shares, the court should refer to the shareholder record, determine the number of outstanding shares, and compare that number with the number held of record by the petitioning shareholders. This solution works very well where the corporation has taken care to follow the usual formalities of share transfer and record-keeping, so that the record accurately reflects the state of ownership interests.

a. The problem of deficient recordkeeping

The simple, arithmetic approach does not work so well, however, where corporate formalities are found wanting. It is not unreasonable to believe that many shareholders hold more than one fifth interest, but the record does not reflect this fact. This is the interpretation of a leading commentator in the field of close corporations, who interprets such statutes as requiring specific percentages of shares to be held by the complaining shareholder. See O'Neal supra note 1, at 612-19. That interpretation does not always satisfactorily resolve ownership measurement question. See infra text accompanying footnotes 49 through 61.
close corporations act so informally as to pay little heed even to the relatively simple task of keeping shareholder records. The records and the shareholders themselves may be unclear as to how many shares are outstanding and who owns them. In such cases, the court has two principal choices for resolving ownership disputes. One choice is to invoke strictly the burden of proof rule upon the petitioning shareholders, whereby any shortcomings of proof in ownership arising from records or testimony would be resolved against the petitioners. While this approach promises simplicity of application, it may not always promote fairness. The majority shareholders, to the extent that they control the corporation, are the persons most likely to be responsible, directly or indirectly, for problems in corporate record-keeping. In such cases the majority's defalcations should not benefit them and disadvantage the minority. If that were the rule, majority shareholders might find it beneficial to be less than punctilious in keeping shareholder records.

A more reasonable approach would be to impose the initial burden of proof respecting the shareholder records upon those responsible for keeping them. In that way, any detriment attributable to deficient record-keeping falls upon the culpable party, not the innocent one. This approach is consistent with the mandate of the statute to "proceed according to the principles and usages of law and equity." Those claiming some benefit from unclear records would be required to demonstrate something akin to "clean hands." In that way, resolution of the minimum interest issue would not rely solely on whether the petitioning shareholders have accurate corporate records available to them.

Where the threshold question of who has been responsible for corporate record-keeping cannot itself be resolved, the court should give minority shareholders the benefit of the doubt by indulging a presumption that the majority carried this responsibility. At least two reasons support this suggestion. First, in most cases the majority does carry the management responsibility for proper record-keeping. Incorporating this normative situation as a presumption would do no harm to the corporate structure and should actually provide an incentive for complying with statutorily required formalities. Second, shoddy corporate record-keeping may be symptomatic of more serious corporate problems that gave impetus to the minority shareholder

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49 Nothing in the statute limits the application of section 134 to close corporations. The statute is not very likely, however, to find common application in the context of a publicly held corporation, if for no other reason than the fact that a 20% shareholder of a publicly held corporation is likely to have sufficient corporate control and influence so as to be able to work a voluntary dissolution and avoid the judicial procedure. See, e.g., W. VA. CODE § 31-1-125 (1984).

50 This assumes, of course, that the majority would view itself as much less likely to resort to section 134 to effect dissolution. Inasmuch as voluntary, non-judicial dissolution is available to the majority, the assumption seems sound. See W. VA. CODE § 31-1-126 (1984). As for the logic of the disincentive to maintain formalities, see Baird v. Franklin, 141 F.2d 238 (2nd Cir.), cert. denied, 323 U.S. 737 (1944).


52 W. VA. CODE § 31-1-105 (1984) provides that the "corporation shall keep . . . a record of its shareholders . . . [including] the number and class of the shares held by each. . . ."
suit in the first place. If record-keeping suffers from extreme disorder, to the point that it is not clear who was to have maintained the records, perhaps minority shareholders deserve a chance to litigate the other problems.

b. The problem of unpaid shares

Also pertinent to the minimum interest requirement is the question of whether the complaining shareholder whose corporation has kept apparently meticulous records will be allowed to challenge the records on some other basis. An example of such a challenge concerns the problem in counting "assessable" shares. If the corporate records show that certain shares are outstanding but are not fully paid up, how are they to be counted in assessing whether the one-fifth in interest requirement has been met? Is the record shareholder to be considered their owner for purpose of the statute? Should resolution of either of these questions depend on the extent to which such shares are paid up or on the reason why they are not fully paid up? Will the court allow shareholders with assessable shares to pay them up at their issue price to clear the ownership question? Or should the court allow them to be belatedly paid up, but only at some current "fair" price, whether greater or less than their issue price?

In resolving these questions, the application of equity principles should also work to the benefit of the minority shareholder. Where the assessable shares are held by the majority or by those opposing the application for dissolution, they should not be counted as owned or outstanding. Such a rule would be consistent both with the obligation of shareholders to pay full consideration for their shares and with the obligation of the corporation to hold share certificates until those shares are "fully paid." One exception to the rule of full payment may exist in section 80 of the West Virginia Corporation Act, which allows share subscriptions (whether made before or after formation of the corporation) to be paid by installment agreement. This suggests that the installment subscriber will be considered the beneficial owner of such shares (unless there is a breach of the installment agreement), but the share certificate will not be issued.

A full payment rule and its one exception should present little problem for the court in applying section 134. In the case of a majority shareholder, the court

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53 See generally, H. HENN & J. ALEXANDER, supra note 18, at 428-31, regarding assessable shares.
54 W. VA. CODE § 31-1-89 (1984) provides the "A holder of . . . shares of a corporation shall be under no obligation to the corporation . . . with respect to such shares other than the obligation to pay the corporation the full consideration for which such shares were issued . . ." (emphasis added). W. VA. CODE § 31-1-87 (1984) provides that "No certificate shall be issued for any share until such share is fully paid." The West Virginia Corporation Act contemplates only cash, property and services or labor actually performed as legal consideration for shares; promissory notes do not constitute legal consideration. W. VA. CODE § 31-1-82 (1984).
55 In this case, the corporation should act under section 31-1-80 to require forfeiture of such shares or immediate payment therefore. In either case the corporation should not count the shares as "outstanding" for purposes of the litigation.
should count only fully paid shares and ignore those not fully paid.\textsuperscript{56} When confronted with a valid installment contract for the benefit of a majority shareholder, it should count shares being purchased under the contract unless the shareholder is in default.

But what about the minority shareholder with assessable shares or in default on an installment contract? Should the same rather strict rule apply? There is a good argument that it should not. A principal reason for careful scrutiny of the majority's shares is the perceived danger that the majority shareholders are often able to play fast and loose with corporate formalities: they might be maximizing their equity and voting power while simultaneously minimizing their risk and expense. Such a danger is radically reduced, or non-existent, with respect to minority shareholders. If minority shareholders hold assessable shares, it is at the mercy of the majority. Therefore, if a minority shareholder controls more shares than he or she has actually paid for, it is with the assent of the majority and not because of any unreasonable and unjustified usurpation of rights. Similarly, if the minority shareholder is in default on an installment contract, it is the majority's right to call it due and demand payment. In short, where unpaid shares of the minority are at stake, the majority may be presumed to recognize the minority as equitable, beneficial owners of such shares. No such presumption should run in favor of the majority's unpaid shares.

c. The problem of multiple classes of shares

The West Virginia Corporation Act authorizes corporations to issue shares "divided into one or more classes, . . . shares with par value or shares without par value, with such designations, preferences, limitations and relative rights as shall be stated in the articles of incorporation."\textsuperscript{57} While multiple classes of shares may be somewhat unusual in the close corporation, the possibility raises the question of how such shares should be counted in calculating proportionate "interests" under section 134. Must there be a computation of the equity value of all outstanding shares? Or would a percentage of outstanding shares suffice, notwithstanding the differing classes and numbers of shares? Would the "percentage outstanding" approach employ a calculation of only those within a given class or of all classes? For example, assume that a minority shareholder owns 18 of 100 outstanding common shares and 21 of 100 outstanding preferred shares. Only where the court looks to preferred shares alone does the shareholder meet the "one-fifth in interest" requirement. Where both classes are aggregated or where the common shares alone are considered, the shareholder does not reach the minimum interest requirement. On the other hand, if the shareholder owned one more share of common or preferred, the aggregate interest of \textit{all} shares rises to one-fifth.

\begin{footnotesize}
\textsuperscript{56} Cf. Hall v. McLuckey, 135 W. Va. 864, 876, 65 S.E.2d 494, 501 (1951) (where shareholder petitioning for dissolution can establish "irregular issue of stock" court will disregard such stock in determining ownership of corporation (dictum)).

\textsuperscript{57} W. VA. CODE. § 31-1-78 (1984).
\end{footnotesize}
The statute’s use of the phrase “in interest” seems to call for a calculation of all corporate equity interest, not just that of a single one class of shares. If that is the case, and the court is to look at all forms of equity interest, it then faces a dilemma arising from the necessity of measurement across classes: should it measure relative total equity interest, or should it simply measure a percentage of all shares outstanding?

Given the context in which the issue would arise—a shareholder suit for dissolution and liquidation—if the court adopts the former approach, it should probably do so by estimating the minority shareholders’ interest upon liquidation. If the petitioning shareholders would receive at least one-fifth in value of the proceeds resulting from a liquidation at the time of the suit, then they would be deemed to have one-fifth in interest of the corporation. Any other measurement of value, such as par or book value, may skew the calculation according to special characteristics of the different classes of shares.

Less consistent with the apparent intent of the statute would be the latter, “shares outstanding” approach. Such an approach would, however, find precedent in the methods of measuring interests employed by other sections of the West Virginia Corporation Act, which rely exclusively on percentages of voting power, as opposed to economic or financial interest. For example, section 105 grants shareholders with sufficient interest the right to examine corporate records upon demand (where acting in good faith and for a proper purpose). The minimum interest requirement of section 105 is “five percent of all outstanding shares of the corporation,” without reference to the nature of the shares or differences between classes.

Similarly, section 108 grants “the holders of not less than one-tenth of all the shares entitled to vote at the meeting” the right to call special shareholders meetings. In that section, the limitation to “shares entitled to vote” is justified by the nature of the special right and effectuated by the requirement that all classes whose interests are at stake have the right to vote. In any event, these provisions do lend some support and even justification for adoption of the “outstanding shares” method of interest calculation over a “liquidation value” or “equity interest” method. If such an approach is adopted, inasmuch as the apparent intent of the statute is to measure overall interest, all outstanding shares

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58 Robinson v. Weimer-Warren Co., 110 W. Va. 143, 157 S.E. 85 (1931) provides a hint. In that case, five founding shareholders had purchased 220 shares each for $5,000 per person. The court noted that plaintiffs had alleged that they owned not less than one-fifth in interest, setting their ownership at "$4500 (180 shares)." Id. The opinion suggests that plaintiffs stressed their ownership in dollar terms while the court made sure to refer to their ownership in terms of shares. Id. at 145, 157 S.E. at 87. The inference that courts will, in the usual case, refer to the respective percentages of outstanding shares is further supported by Masinter, 262 S.E.2d at 437 n.3. It should be noted that any measurement of interest is subject to manipulation by controlling parties who undertake to issue new equity interests to themselves.


60 Id.

should be counted as equal, and percentage ownership levels within classes should be ignored.

To resolve the equity measurement problem, however, courts could give minority shareholders the opportunity to prove the requisite ownership percentage using either method. That would help to protect against the simple forms of majority manipulation such as the issuance of numerous shares of low equity stock.

It may be that concern about the proper method of calculating shareholder interest under section 134 is largely academic, since section 41 of the West Virginia Corporation Act also allows minority dissolution suits, and does so without imposing a minimum shareholder interest requirement. Therefore, at the very least, those minority shareholders who cannot convince a court that they satisfy the "one-fifth in interest" requirement of section 134 may consider resorting to section 41 for judicial dissolution and liquidation.

But other reasons exist for aggrieved shareholders to bypass section 134 in favor of section 41. One reason is that the two statutes articulate different grounds for dissolution and liquidation. Section 41 takes the route of prescribing specific grounds, such as management deadlock, management fraud, corporate waste, etc. In apparent contrast, section 134 takes a more general approach, allowing dissolution only where "sufficient cause therefore be shown." Unfortunately, as with the meaning and measurement of "one-fifth interest," the phrase "sufficient cause" is so problematic as to lessen the utility of section 134.

2. The "Sufficient Cause" Requirement of Section 134

Whether any of the myriad forms of freeze-out and oppressive behavior, such as those described above, meet the "sufficient cause" requirement for judicial dissolution under section 134 is an issue left largely unresolved by precedent. Case law, domestic and foreign, provides only a sketchy outline of the scope of sufficient cause. Unlike phrases such as "fiduciary duty," "trust relationship," and (as we shall see) "oppression," this lack of precision may suggest dysfunctional rigidity more than helpful flexibility.

Though minority shareholders of West Virginia corporations have in the past sought involuntary dissolution under section 134 (and its precursors), research discloses no case in which a court has actually granted dissolution after finding "sufficient cause." This fact gives rise to at least two reasonable inferences with

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62 See infra text accompanying notes 79 through 143 for discussion of the application of section 41.
65 See generally Comment, Oppression as a Statutory Ground for Dissolution, 128 Duke L.J. (1965) (where author concludes that the very elusiveness of a definition of "oppression" as ground for dissolution is a strength not a weakness, because it provides for flexibility).
66 The court did grant dissolution in Williams v. Croft Hat & Notion Co., 82 W. Va. 549, 96
respect to interpreting the "cause" requirement. First, the burden of proof upon petitioning shareholders in demonstrating sufficient cause has probably been quite heavy. Second, though the courts have provided little definitional guidance by way of positive precedent, the past decisions may help to define what does not constitute sufficient cause. Some brief attention to these cases helps to illustrate this point.

In a very early case, Law v. Rich, a creditor brought suit in equity to force the dissolution of the debtor corporation, which had ceased doing business. The court, relying on a precursor to section 134, held that it had no jurisdiction to decide the case. While the court's reasoning is unclear, it appeared to conclude (in dictum) that cessation of business or "non-user" is not sufficient cause to justify dissolution under the statute. This suggests that majority shareholders face no threat of involuntary dissolution under section 134 where they cause the corporation to cease business activity because occasional suspensions of business may be "advisable" and in the interests of the stockholders.

A few years later, in Ward v. Randolph Hotel Co., a forty-nine percent shareholder sued for dissolution under the statute, alleging that the corporation faced insolvency because of mismanagement and misappropriation of corporate funds by the controlling shareholder. In reference to the cause requirement, the court held it a prerequisite to relief that the shareholder have exhausted avenues of redress through "corporate authorities." Because plaintiff together with one ally did control a majority of the stock and therefore had the legal right to vote the miscreant parties off the board, the court held that he was not entitled to the remedy in equity that the statute was deemed to provide. Ward may be helpful to minority shareholders only in the converse: where minority shareholders do not wield sufficient power to obtain relief by self-help through internal corporate mechanisms, they may have no alternative remedy at law. Consequently, they may seek the statutory equitable relief for mismanagement of the corporation.
That might neatly conclude the interpretation of *Ward* if it were not for one loose end of dictum. In decrying the insufficiency of the complaint, the court said that there was no "sufficient cause shown, unless the insolvency suggested be sufficient cause, for winding up the affairs of the corporation. . . ." This language indicates that the court believed mismanagement and misappropriation by the controlling shareholders would not, without more, justify involuntary dissolution. The complaint lacked averment of some enduring problem such as insolvency. Given the facts of the case, however, including the potential control power by the plaintiff, it makes little sense to emphasize this dictum. It makes even less sense to require a minority shareholder to wait until the majority's defalcations cause actual insolvency before seeking equitable relief under the statute.

A more modern case, *Hall v. McLuckey*, clarifies the ambiguity in *Ward*. In *Hall*, the minority complained of the majority's failure to pay dividends, its failure to give notice of shareholder and board meetings, and its mismanagement and misappropriation of corporate assets. Acting under a predecessor of section 134, the first trial court appointed a special receiver and ordered an audit of the company. The supreme court reversed, intimating that mismanagement and fraud might justify dissolution under the statute, but holding that the complaint must state specific irregularities, not simply generalities and conclusions. After a second trial court sustained the defendant's demurrers to an amended, more specific, complaint, the supreme court again reversed, holding, *inter alia*, that misappropriation of corporation assets "would constitute mismanagement of the company and would justify the relief authorized" under what is now section 134.

The most recent reported case under section 134, and the most instructive in regard to minority shareholder freeze-outs, is *Masinter v. WEBCO Co.* Masinter and two others had formed a corporation as equal shareholders. The three shareholders served as the corporation's only directors and officers and received return on their investment in the form of salaries rather than dividends. After several
years of business, Masinter had a falling out with the other two shareholders and shortly thereafter found himself removed from the board, denied employment with the business, and excluded from any other participation in management. In addition, the corporation opened up a retail outlet in another city that competed directly with Masinter's other business. Alleging freeze-out and unfair competition, Masinter sued for dissolution of the corporation. The trial court granted summary judgment against him, apparently on the ground that certain evidence he had adduced by deposition did not warrant the "drastic" remedy of dissolution of the corporation. Applying the same standards as for ordering dissolution, the trial court also dismissed a related damage claim for "oppressive conduct." The supreme court reversed, holding that minority shareholders may still have causes of action for damages arising from fiduciary breaches and "oppression" even where they cannot meet the more rigorous standard for dissolution.

While Masinter failed to obtain a dissolution order, the court's opinion does provide some helpful guidance in defining "sufficient cause." As in McLuckey, the supreme court distinguished between "mere procedural irregularities," which would probably not support an action for dissolution, and more serious freeze-out and oppression tactics by the majority, which in some cases would warrant judicial dissolution. It so happened that most of the alleged oppressive tactics in Masinter—loss of employment, failure to declare dividends, and withholding information—were not only within the legal rights of the majority to impose, but also were somewhat justified by the facts of the case. The court had therefore seemed relatively unimpressed with either their severity or their detriment to Masinter. Nonetheless, the court did note that such tactics were of an "oppressive" character and, had they been applied with less justification or caused more serious harm, dissolution might have been justified. In any event, the court held that minority shareholder complaints that do not warrant an order for complete dissolution may nonetheless suffice to support an award of damages or some other, lesser alternative to the death of the corporate entity.

B. Liquidation and Dissolution under Section 41

Section 41 of the West Corporation Act grants "full power" to West Virginia courts of general jurisdiction to order and supervise the liquidation and dissolution of corporations at the instance of any shareholder. The statute's use of the term

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79 Id. at 437-43.
80 Id. at 440.

Section 41 provides, in pertinent part:

Jurisdiction of court to liquidate assets and business or affairs of corporation; when such actions may be brought; venue; parties.

(a) Any of the circuit courts or inferior courts of record with general civil jurisdiction shall have full power to liquidate the assets and business or affairs of a corporation in an action by a shareholder or member when it is established:
“power” suggests that the authority may be exercised discretionarily. Thus, even where the complaining shareholder meets the burden of establishing one of the grounds for liquidation, the court is under no statutory obligation to order the requested relief. Unlike section 134, section 41 does not articulate a procedure whereby the majority may avoid dissolution by paying fair value for the minority’s shares. Nonetheless, it seems clear that a court acting under section 41 has the equitable power to provide the buy-out opportunity for the majority.

As already noted, in contrast to section 134, section 41 contains no minimum shareholder interest requirement. The court may order a corporation liquidated and dissolved at the request of any shareholder, no matter how small the shareholder’s interest in the corporation, as long as the shareholder establishes one of the specified grounds for justifying liquidation. The four grounds set forth in the statute actually encompass at least six discrete bases warranting liquidation: (1) board deadlock; (2) shareholder deadlock; (3) illegal acts by the controlling parties; (4) fraud by the controlling parties; (5) oppressive conduct by controlling parties; and (6) corporate waste. As will be shown, successful petitions for dissolution will usually require the minority shareholder to establish one or more of these grounds as particularly egregious, harmful, or chronic. Where the shareholder falls short of such proof, however, the West Virginia Supreme Court of Appeals has suggested that trial courts should consider other, lesser remedies including: appointment of tem-
porary receivers, injunctive relief, accountings, and conditional orders of dissolution.\textsuperscript{85}

1. Deadlock

While wrongful acts such as illegality, fraud, oppression, waste, or any combination of these are most likely to form the heart of a freeze-out attempt, deadlock problems may also contribute to freeze-out problems and therefore warrant a similar concern.

a. Board Deadlock

To justify liquidation under section 41 because of a board deadlock, there must exist, not only the paralytic condition of a board divided evenly and unable to take action, but also some "irreparable injury" to the corporation, whether real or threatened. Board deadlock arises all too often in close, and especially family, corporations where an egalitarian spirit at the outset of the enterprise leads to a shared power arrangement. Directorships and voting stock are often divided equally between two factions. Once dissension raises its head, the harmony required to foster corporate action is lost.\textsuperscript{86} But deadlock alone is not sufficient to warrant

\textsuperscript{85} \textit{Masinter}, 262 S.E.2d at 439-440. \textit{Masinter} cited with apparent approval ten forms of relief "short of outright dissolution," against freeze-outs and oppressive conduct that the Oregon Supreme Court had recommended in \textit{Baker v. Commercial Body Builders, Inc.}, 264 Or. 614, 632-33, 507 P.2d 387, 395-96 (1973). These ten forms of relief are as follow:

(a) The entry of an order requiring dissolution of the corporation at a specified future date, to become effective only in the event that the stockholders fail to resolve their differences prior to that date.

(b) The appointment of a receiver, not for the purposes of dissolution, but to continue the operation of the corporation for the benefit of all of the stockholders, both majority and minority, until differences are resolved or 'oppressive' conduct ceases.

(c) The appointment of a 'special fiscal agent' to report to the court relating to the continued operation of the corporation, as a protection to its minority stockholders, and the retention of jurisdiction of the case by the court for that purpose.

(d) The retention of jurisdiction of the case by the court for the protection of the minority stockholders without appointment of a receiver or 'special fiscal agent'.

(e) The ordering of an accounting by the majority in control of the corporation for funds alleged to have been misappropriated.

(f) The issuance of an injunction to prohibit continuing acts of 'oppressive' conduct and which may include the reduction of salaries or bonus payments found to be unjustified or excessive.

(g) The ordering of affirmative relief by the required declaration of a dividend or a reduction and distribution of capital.

(h) The ordering of affirmative relief by the entry of an order requiring the corporation or a majority of its stockholders to purchase the stock of the minority stockholders at a price to be determined according to a specified formula or at a price determined by the court to be a fair and reasonable price.

(i) The ordering of affirmative relief by the entry of an order permitting minority stockholders to purchase additional stock under conditions specified by the court.

(j) An award of damages to minority stockholders as compensation for injury suffered by them as the result of 'oppressive' conduct by the majority in control of the corporation.

\textsuperscript{86} \textit{See}, \textit{e.g.}, \textit{Niedorff}, 307 N.Y. 1, 119 N.E.2d 563 (sister refused to authorize compensation for
involuntary liquidation under the statute. The shareholder seeking the remedy must also establish that the deadlock is causing or is likely to cause "irreparable injury." 18

Neither the board deadlock provision nor its accompanying irreparable injury requirement is unusual in the context of dissolution statutes. For example, Indiana, Illinois, Pennsylvania, and Missouri have had similar statutes for many years. 19 Under these statutes, as under section 41, relief on the ground of board deadlock usually turns on whether irreparable injury exists. The interpretation of "irreparable injury" has ranged from very strict in Illinois to more liberal in Pennsylvania and Missouri. In the latter states the courts have construed the phrase to include injury either to the corporation as a separate legal entity and/or to the corporation as a community of shareholders. 20

b. Shareholder Deadlock

Section 41 also allows for liquidation and dissolution where deadlock at the shareholder level has led to the corporation's inability to elect successor directors for two annual elections. 21 Judicial relief from this form of deadlock does not require a showing of irreparable injury to the corporation or shareholders. Presumably, the prospect of perpetual management by those incumbent at the onset of deadlock is considered sufficient injury, for if new directors cannot be elected, the incumbent directors will remain in office indefinitely. 22 One of the most famous shareholder deadlock problems arose in a New York case, *Gearing v. Kelly,* 23 where the resignation of one of four directors led to the replacement of that director by the remaining three members of the board. Two of the remaining directors, who represented the interests of one fifty percent shareholder faction, appointed as a new director a person who would also represent their faction. That left the board with three directors representing one shareholder faction and one director representing the other, even though each shareholder faction controlled half the voting stock. Subse-

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19 *Lush's Brand Distributors Inc. v. Fort Dearborn Lithograph Co., 330 Ill. App. 216, 224, 70 N.E.2d 737, 741 (1946).*
22 *W. Va. Code § 31-1-21 (1984) provides: "Each director shall hold office for the term for which he is elected and until his successor shall have been elected and qualified." (emphasis added).*
quent elections would naturally have resulted in deadlock and the board imbalance would continue so long as the shareholder deadlock could not be broken. The board's power imbalance clearly set the stage for a freeze-out.

It is important to remember that, although section 41 may provide a remedy for this specific shareholder deadlock situation, it is not a particularly swift remedy. The statute requires shareholders to suffer through two election periods before they may seek liquidation under the statute. It goes without saying that much mischief can occur in the two to three year period before the statutory remedy ripens.

Whether at the board or shareholder level, many deadlocks involve the inability of the corporation to make and implement necessary business decisions because no faction is able to muster the majority support needed to authorize such decisions. In the worst cases of such corporate paralysis, the corporation actually ceases to function.

As noted above, in other situations the status quo maintained by deadlock will be the incumbency of an active, controlling faction. That faction will retain the legal or actual power to manage the enterprise, often to the exclusion of the other faction. If the corporation is not making a profit and its existence is in jeopardy, management deadlock may amount to irreparable injury sufficient to warrant judicial liquidation and dissolution. Where the corporation is profitable, however, and no irreparable injury threatens, frozen-out shareholders might still desire similar relief. In such situations, as well as in cases where deadlock is not a problem, the other four grounds for liquidation and dissolution—oppression, fraud, illegality, and waste—come into play.

2. Oppressive Conduct by the Majority

Those who yearn for a liquidation criterion more certain of application than section 134 and more general in application than section 41's deadlock provisions (at least in regard to freeze-outs) may take heart from the "oppression" provision of section 41. For if freeze-outs have any effect on the minority, it is an oppressive one.

Section 41 does not define "oppressive conduct," but the concept has been with us in the context of involuntary liquidation and dissolution statutes since 1933. Despite, or perhaps because of its longevity, the concept has eluded precision of definition. Given the myriad methods by which one person may oppress another in the corporate context, general definitions have proved to be not only elusive

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*See, e.g.,* Petition of Collins Doan Co., 3 N.J. 382, 70 A.2d 159 (1949); Annot., 13 A.L.R.2d 1250 (1950) (where corporation had not functioned for ten years, the court, acting under Model Business Corporation Act-type statute, opined that the very fact of deadlock creates corporate paralysis sufficient to require dissolution).

*Cent. Stanard*, 10 Ill. 2d 566, 567, 141 N.E.2d 45, 50 (citing Illinois statute).
but also of little value in specific cases. Many courts quote with favor the definition formulated by a 1952 Scottish case, which construed "oppression" to mean a "visible departure from the standards of fair dealing, and violation of the conditions of fair play upon which every shareholder who entrusts his money to a company is entitled to rely." A second Scottish case, also widely quoted, added that oppression is "burdensome, harsh, and wrongful" conduct involving a "lack of probity and fair dealing in the affairs of the company to the prejudice of some portion of its members." In Masinter, the leading West Virginia case regarding oppressive conduct in the context of a freeze-out, the court held that both of these descriptions find kinship with the usual formulations of the fiduciary duty owed by majority stockholders to the minority.

Oppressive conduct in the context of a freeze-out might focus on any of the three categories of shareholder rights and interests. With respect to the minority's expectations of participation in control of the corporation, it seems manifestly oppressive for controlling shareholders to reduce or eliminate the power and voice of the minority in corporate management. This is especially true where the reduction or elimination is the product of a failure to follow corporate formalities or is done without a business purpose. The West Virginia Supreme Court of Appeals seems to agree on this point. For example, in Hall v. McLuckey, the controlling shareholder had allegedly denied the complaining shareholder, a corporate officer and one of three directors, the right to participate in management by only providing notice of board and shareholder meetings to the third director, an ally in the freeze-out. Similarly, in an Illinois case, Compton v. Paul K. Harding Realty Co. the court ordered dissolution where the minority shareholder, who was the executive vice president and treasurer of the corporation, had been ignored in the management process and bullied by an imperious president. In that case, the court emphasized that "oppression" may be found in denial of management participation, even absent outright mismanagement, misappropriation of assets, or the hint of imminent corporate disaster. In other words, the capricious and overbearing

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96 Baker, 264 Or. at 628-29, 507 P.2d at 393-94 (1973), cited with approval in Masinter, 262 S.E.2d at 440.
99 Masinter, 262 S.E.2d at 440 n.11.
100 See supra text accompanying notes 18-39.
101 See Note, supra note 95 at 171-73.
103 Compton, 6 Ill. App. 3d 488, 285 N.E.2d 574.
104 Id. at 495, 285 N.E.2d at 581.
actions of a majority shareholder may suffice to justify dissolution, at least where internal corporate mechanisms cannot resolve the problem.

Oppression may also take the form of depriving minority shareholders of income from the corporation. As described in more detail in the discussion of freeze-out tactics, majority shareholders might refuse to make corporate distribution and to employ the minority, the combined effect of which is to deny the minority any return on their investment. Because corporations have no general obligation to declare dividends or employ certain persons, these facts alone may not justify dissolution. But where decisions regarding dividends or employment are made capriciously or maliciously in violation of the majority's fiduciary duties, justification for dissolution may exist. Although commentators place emphasis on how serious the fiduciary breach must be to warrant the dissolution remedy, it is clear that the breach need not amount to fraudulent or illegal behavior. Courts interpreting "oppression" consistently advert to the importance of recognizing it as a ground distinct from "fraud" and "illegality."

Whatever the nature of the oppressive behavior, where the oppressive conduct has been of short duration or has ceased well before the dissolution action commenced, courts may be reluctant to order outright liquidation and dissolution. The statutory concern, as interpreted by the courts, seems to focus on the "cumulative effects of . . . many acts and incidents, and their . . . continuing nature."

Although courts may emphasize the duration of the oppressive conduct in formulating remedies, they do not consistently consider the financial impact that the conduct has on the corporation. Some courts apparently look to the economic viability of the enterprise as a guide in deciding between dissolution and other, less drastic remedies. The absence of profitable prospects might in itself warrant

105 See supra text accompanying notes 22-29.
106 E.g., White, 213 Va. 129, 189 S.E.2d 315 (majority shareholder of "S" corporation refused to declare dividends even though minority shareholders had to pay taxes on earnings); Wilkes, 370 Mass. 353 N.E.2d 657; Baker, 264 Or. 614, 507 P.2d 387.
108 Masinter, 262 S.E.2d at 440 ("oppression" subsumes standards for fiduciary duties owed to minority by majority shareholders, officers and directors of corporation.); White, 213 Va. 129, 189 S.E.2d 315; Comment, supra note 95 at 133 (citing authority for close and substantial correlation between serious breaches of fiduciary duties and "oppression").
109 E.g., Gidwitz, 20 Ill. 2d at 214-15, 170 N.E.2d at 138 ("It is not necessary that fraud, illegality or even loss be shown to exhibit oppression."); Central Standard, 10 Ill. 2d at 573, 141 N.E.2d at 50 ("[T]he word 'oppressive' does not necessarily savor of fraud. . . .").
110 Compare Baker, 264 Or. 614, 507 P.2d 387 (In denying remedy of dissolution, court took note of fact that alleged oppressive conduct has ceased some two years before case was tried) with Gidwitz, 20 Ill. 2d 208, 170 N.E.2d 131 (50% shareholder ran roughshod over other 50% shareholder for over 10 years and completely excluded him from management and employment.).
111 Id.; Comment, supra note 95 at 136.
dissolution in some cases; that is, the court might believe that holding the minority's interest captive in such cases is inherently oppressive. One factor that may tilt the balance is the presence vel non of bad faith on the part of the controlling shareholder.

The West Virginia Supreme Court of Appeals has not had the opportunity to provide much guidance in the search for a useful definition of "oppression." It has, nonetheless, adopted broad and malleable language from the mainstream of cases addressing the issue. At least one thing is certain: the court has articulated its clear understanding that, whatever "oppression" may encompass, it certainly includes the most deleterious of the various forms of fiduciary breach that we have come to know as "freeze-out."

3. Fraud on the Part of Controlling Persons

Section 41 also authorizes liquidation and dissolution where the minority shareholder can demonstrate "fraudulent acts" on the part of the directors or those in control of the corporation. Although fraud comprehends a wide variety of mischievousness, in this context two types are rather common: deception by the withholding of information from the minority and misappropriation of corporate assets.

As noted previously, the majority’s withholding of information about corporate activities is a classic freeze-out tactic. It is a tactic that may enhance the effectiveness of other freeze-out tactics merely by concealing their existence. An example of this is keeping corporate assets off the books so that the controlling party may more easily misappropriate the assets from the corporation. Another example is a new issuance of stock to the majority without notice to the minority.

Withholding information can be taken to an extreme, as evidenced by one case in which withholding information amounted to a complete squeeze-out. Samia v. Central Oil Co., involved brothers who had concealed from their sisters for fifteen years the fact that the sisters also had inherited a share of the family business. Concealing the truth enabled the brothers to avoid paying dividends to the sisters, to enhance their own proprietary interests by issuing themselves additional stock, and to siphon off corporation assets through another corporation they had established. Eventually internecine squabbles caused the truth to be revealed to the defrauded sisters.

113 Polikoff v. Dole & Clark Bldg. Corp., 37 III. App. 2d 29, 184 N.E.2d 792 (1962) (dictum); Comment, supra, note 95 at 136 n.40. That would be consistent with the conceptual alignment of "oppression" and "breach of fiduciary duty" found in the principal West Virginia case, Masinter, 262 S.E.2d at 440-42.
114 Masinter, 262 S.E.2d at 440-42.
115 Central Standard, 10 III.2d 566, 141 N.E.2d 45 see generally O'NEAL, supra note 1 at §§ 3.09, 3.16.
116 See supra text accompanying note 37.
118 Id. at 105, 158 N.E.2d at 473.
Whether the minority’s informational detriment is the result of mere omission or affirmative misrepresentation, it amounts to fraud where it is intentional. The majority’s fiduciary duty to the minority includes the duty to inform them of material facts regarding the corporation and their interest in it.119 But the minority’s success in proving a fraudulent omission or misrepresentation will not always result in dissolution of the corporation.120 Rather, as with cases of oppression, the court will likely weigh the egregiousness, duration, and curability of the fraud in determining the severity of the remedy. Because fraud of this sort amounts to a breach of fiduciary duty, injunctive relief and damages, where appropriate, are common remedies.121 In cases where the withholding of information is either justifiable, non-continuing, or merely a technical, nonmalicious violation of state law or the corporate charter, then dissolution under the statute is highly improbable.122

Sometimes the majority’s fraud upon the minority amounts to outright conversion of corporate property to personal use, which may cross the line into “illegality,” another ground for dissolution.123 Often such defalcations will not violate the criminal laws, at least as a technical matter, because of “corporate” approval of the questionable transactions. Such transactions may nonetheless amount to a fraud upon the minority where they are undertaken surreptitiously and deceptively.124 Professor O’Neal cites as the most common abuse of this sort the inflation of corporate expense accounts by those in control.125 In addition to the straightforward tactic of rifling the corporate cash register,126 other common schemes include corporate “featherbedding” by putting family members on salary while requiring and receiving no services;17 use of corporate funds or property for personal benefits;128 and diversion of payments intended for the corporation to personal use.129

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121 See O’NEAL supra note 1 at § 7.13. See Masinter, 262 S.E.2d at 441-42.
122 E.g., Masinter, 262 S.E.2d at 438-39, 442-43.
123 See infra text accompanying notes 131-137 for a discussion of illegal conduct by controlling persons as a ground for dissolution.
124 Where the taking of corporate property is done openly and with the approval of those in control, the theory of wrongdoing would likely be “waste” rather than fraud. Section 41 provides for dissolution on the ground of “waste” also. W. VA. CODE § 31-1-41(a)(4) (1982).
126 E.g., Ross, 130 Ill. App. 2d 336, 264 N.E.2d 406 (majority took nearly $50,000 from corporation, claiming it was a loan to a second corporation owned by the majority).
128 E.g., Felsenheld, 119 W. Va. 167, 192 S.E. 545 (majority used corporate funds to speculate in stock market); Charles v. Epperson & Co., 258 Iowa 409, 137 N.W.2d 605 (1965) (personal use of corporate station wagon).
129 Charles, 258 Iowa 409, 137 N.W.2d 605 (president diverted payments for farm equipment sold
Because misappropriation damages the corporation directly and the minority only indirectly, most such cases are brought by the minority shareholders derivatively. Remedies usually include repayment of the misappropriated funds, or return of the property or its value to the corporation. Some fraudulent acts are so egregious as to warrant the award of punitive damages. The fundamental shortcoming of damage remedies, however, is that they often leave the wrongdoer in control of the corporation with little incentive for proper behavior in the future. And given the high costs of litigation, minority shareholders are not likely to bring repeated damage actions unless the stakes are very high. Thus, at least in cases of chronic deception, misappropriation, and fraud, dissolution is the appropriate remedy.

4. Illegal Acts by Controlling Persons

As with other grounds relating to malfeasance by the directors or controlling persons, including oppression and fraud, section 41 does not define or specify what “illegal acts” might warrant ordering dissolution of the corporation at the request of a shareholder. Three general categories of illegal acts would seem sufficient to make dissolution of the corporation a reasonable remedy.

First, the corporation itself might engage in illegal acts at the direction of the controlling persons. Typical of such cases would be those acts by which the corporation pays kickbacks or bribes to secure business contracts, engages in price-fixing in violation of the antitrust laws, or intentionally dumps wastes in violation of environmental protection regulations. Second, persons controlling the corporation might engage in unlawful acts in their individual capacities either wholly unrelated to the corporation’s business or so tangentially related that the corporation and its shareholders incur no direct and immediate harm. Examples of this category might include crimes such as extortion, income tax evasion, or perjury, the principal effect of which is to leave the shareholders without confidence in the integrity of management. The third category of illegal conduct would include actions by the controlling persons inconsistent with the legal requirements, formalities, and duties of managing a corporation. Such acts might be as straightforward and artless as failing to keep the corporate records in the manner required by law or as disingenuous and perfidious as breaching duties of care and loyalty.

by corporation to personal use); Jason Winter’s Herbaltea (Bahamas) Ltd. v. Flemming Imports Corp., 494 F. Supp. 828 (E.D. Ill. 1980) (president took royalty payments due corporation).

130 O’Neal, supra note 1 at § 3.16 at p. 151.

131 Id.

132 E.g., Charles, 258 Iowa 409, 137 N.W.2d 605 (award of $7,500 in exemplary damages for fraud on corporation and shareholders); Mulder v. Mittlestadt, 352 N.W.2d 223 (Wis. Ct. App. 1984) (award of punitive damages to corporation for malicious acts depleting corporation’s capital); Crawford, 57 Md. App. 11, 469 A.2d 454 (award of punitive damages against director and officer of corporation in favor of other directors, officers and shareholders where fraudulent conduct was “malicious, deliberate, gross or wanton.”)

133 W. Va. Code § 31-1-21 (1984) requires that the corporation maintain accurate corporate books
No West Virginia cases, and few other cases decided under statutes similar to section 41, have addressed the issue of dissolution for illegal acts by controlling persons. In Fix v. Fix Material Co., Inc., a Missouri case, the court was confronted with a suit for dissolution under a statute with an illegality provision identical with that of section 41. The minority shareholder contended that management had raised prices of its ready-mix concrete with the intention of joining a price-fixing conspiracy thought to be industry-wide. It turned out that there was no such conspiracy, and the company lost a number of bids and a great deal of money through management’s errant attempt to break the law. Because the complaining shareholder’s allegations were insufficient to establish illegal price-fixing under state law, the court held that dissolution was not warranted. The court did comment, however, that such behavior, coupled with other acts constituting oppression, if not brought to a swift halt could warrant dissolution at a later time. The court also adverted to the less drastic alternatives to dissolution available for fashioning remedies for aggrieved minority shareholders.

The complaining shareholders in Adolphus v. Zebelman, an Eighth Circuit case, were also denied the dissolution remedy on the ground of illegal conduct by controlling persons. In that case the majority shareholders had caused the corporation to convey land in violation of the Interstate Land Sales Full Disclosure Act. The minority—fifteen percent shareholders—sued to enjoin the unlawful conduct, to have a receiver appointed, and to dissolve the corporation. The trial court found that the corporation had violated the law, but declined to order relief beyond an injunction. The court of appeals affirmed without discussion of the illegality issue.

The failure of the courts in Adolphus and Fix to elaborate on the illegality issues may suggest that a corrupt majority will not in itself always warrant dissolution of the corporation. As with the grounds of fraud and oppression, the inappropriate conduct must be chronic before it is likely that dissolution will be ordered.

Research discloses no cases dealing with extracorporate illegality on the part of directors and controlling persons. It is reasonable to conclude, however, that absent harm to the corporation, minority shareholders may be left to procedures such as a motion to remove the miscreants. If that is the case, the majority will likely prevail in retaining their positions of control unless the disclosure of illegal conduct on the part of some members of the majority bloc will drive others to the side of the minority.

As to intracorporate illegalities, such as failure to comply with the technical requirements of corporate recordkeeping, breach of fiduciary duties, etc., the salient

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135 Id. at 361.
136 Id. at 357. See infra note 85, listing some lesser alternatives.
137 Adolphus v. Zebelman, 486 F.2d 1323 (8th Cir. 1973).
decisional factors will undoubtedly be the amount of harm to the corporation (and thus to the shareholder community) and the duration of the defalcation or illegal conduct. In most instances, such intracorporate illegality will fall under the already discussed categories of oppression or fraud and the standards for dissolution in such cases will apply. Where there is a technical violation or failure to follow corporate formalities, relief as drastic as dissolution is highly unlikely.  

5. Waste

Allegations of waste and misapplication of corporate assets have long been common in dissolution suits, although they are usually accompanied by other allegations of wrongdoing on the part of management. In fact, before statutes empowering courts to order corporate dissolutions at the request of minority shareholders became the norm, a court first arrogated to itself the power to order corporation dissolution based on a theory of waste.

In *Miner v. Belle Isle Ice Co.* plaintiff Miner had begun his involvement in the corporation as president and had owned forty-three percent of the stock. Defendant Lorman had owned an equivalent interest and was manager. Lorman then gained an outright majority interest by buying out other stockholders. Thereafter, Lorman discharged Miner from employment, refused to convene proper shareholder meetings, refused to pay dividends, and raised his own salary. But perhaps most supportive of the dissolution petition was the proof of spoliation: the corporation rented property jointly (and equally) owned by Miner and Lorman, but it paid Lorman two-and-one-half times the rent it paid to Miner.

The existence of corporate waste by itself, however, is only in the most egregious cases likely to warrant a dissolution remedy. A principal reason for this is the business judgment rule. Where management acts in good faith in the process of misapplying corporate assets, it will often be difficult for the complaining shareholder to get the court to substitute its judgment for incumbent management's. But where the waste smacks of bad faith or is accompanied by other misconduct on the part of the controlling persons, dissolution is appropriate.

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138 *Masinter*, 262 S.E.2d at 439.
139 *Hetherington and Dooley*, *supra* note 9 at 64-75.
142 E.g., *Polikoff*, 37 Ill. App. 2d 29, 184 N.E.2d 792 (acts of majority stockholder and president alleged to have paid himself excessive salary, to have caused the corporation to mortgage its property to him and his wife, to have failed to have rehabilitated the principal asset of the corporation and to have taken steps to lease it out, etc., were said by the court merely to be the exercise of business judgment.)
IV. CONCLUSION

Minority shareholders suffering majority shareholder misconduct, particularly freeze-out tactics, may defend against such misconduct by seeking involuntary dissolution of their corporation as a remedy. West Virginia provides two statutory bases for dissolution at the instance of minority shareholders. The older of the statutes has little history of successful use and places significant hurdles before the minority shareholder, including a one-fifth interest requirement and a sufficient cause standard, both of which raise substantial interpretive problems. The newer statute, from the Model Business Corporation Act, does away with the interest requirement and sets forth more specific grounds warranting dissolution. The leading West Virginia case addressing the issue of involuntary dissolution indicates that minority shareholders, to be successful, must establish continuing or egregious misconduct on the part of the majority. However, where the minority fails to carry its burden of proof and complete dissolution is denied the court should still consider the lesser alternatives to dissolution suggested by Masinter, such as ordering the majority to buy out the minority at a fair price, thereby saving the minority from the perpetual squeeze of the illiquidity vise.