with added force. In bankruptcy cases involving large corporations, the court must appoint an independent trustee charged with the preparation of the plan. Furthermore, the plan and activities of committee members are directly under the court's control. Under these circumstances the danger from speculative purchases by insiders would seem much less serious than in cases of extra-judicial liquidation or reorganization. In reorganizations involving debt securities, moreover, security-holders of various classes are typically represented in the negotiations concerning the plan by separate committees or agents. In a stock readjustment, however, the plan is often prepared by corporate officers and directors who are interested in the junior shares. Where the plan is neither the product of adversary negotiations nor subject to direct judicial control, there would seem special need to protect the directors from the temptations of the market.

DISSOLUTION OF A SUBSIDIARY CORPORATION A TRAP FOR THE UNWARY PARENT*

A prolific source of litigation has been the existence of a minority stock interest in a subsidiary managed by officers of its parent corporation. Dissolution of the subsidiary is often resorted to as a means of terminating the troublesome situation.[1] The difficulties inherent in the dissolution device, however, are strikingly illustrated in recent litigation involving the Inland Steel Company and its ore-carrying subsidiary incorporated in West Virginia.[2] In each of its two opinions, the Circuit Court of Appeals for the Seventh Circuit enunciated two propositions: 1) that, under the West Virginia statute providing for dissolution upon the vote of holders of sixty per cent of the shares of capital stock, a prosperous corporation may be dissolved regardless of motive and expediency; and 2) that, in the event of such a dissolution, if the majority stock holder purchase the corporate assets, the minority have a cause of action unless the majority pays the fair value of the assets, including the going concern value of the business. The situation to which these principles were applied was analyzed by the court, as one in which the majority stockholder brought about the dissolution of the corporation and the sale of its assets in order to get rid of the minority. Although the price paid was conceded to have been a fair price for the physical assets, nothing had been added for intangibles, and the majority stockholder was held to have improperly appropriated the going concern value of a prosperous business.

At common law most courts have held that neither the dissolution nor the sale of the entire assets of a prosperous corporation can be accomplished without

* Lebold v. Inland Steel Co., 125 F. (2d) 369 (C.C.A. 7th 1941), cert. den. 62 S. Ct. 1045 (1942).

[1] Hornstein, Voluntary Dissolution—A New Development in Intracorporate Abuse, 51 Yale L. J. 64 (1941).

[2] Lebold v. Inland S. S. Co., 82 F. (2d) 351 (C.C.A. 7th 1936); Lebold v. Inland Steel Co., 125 F. (2d) 369 (C.C.A. 7th 1941), cert. den. 62 S. Ct. 1045 (1942).

the unanimous consent of the stockholders.[3] The argument underlying this rule is that the corporate charter is a contract between the stockholders for specified purposes, and that dissolution or sale would be a negation of these purposes and a breach of the contract.[4] On the other hand, those courts which have permitted the dissolution of a prosperous corporation by a majority vote of the stockholders have argued that the continuation of the corporate enterprise is a matter of business judgment similar to other questions of corporate policy entrusted to the majority stockholders.[5] This argument apparently prevailed with most of the legislatures, for statutes have become almost universal permitting corporations to dissolve, or to sell their entire assets, upon the approval of a specified percentage of the stockholders.[6]

Under such statutes, dissolution has often served as a convenient device to eliminate minority interests.[7] Corporate combinations have frequently involved as a first step the making of a purchase or exchange offer to all the stockholders of the corporation to be absorbed. After a large majority of the shares has thus been acquired, the dissolution technique has been used to bring about the acquisition of the assets and the retirement of the minority shares.[8] In the face of such a statute, most courts have refused to interfere with either the dissolution proceedings or with the sale of the entire corporate assets, unless "actual fraud" on the part of the management is shown.[9]

Although the rule that the majority stockholders stand in a fiduciary rela-

[3] American Seating Co. v. Bullard, 290 Fed. 896 (C.C.A. 6th 1923); People v. Ballard, 134 N.Y. 269, 32 N.E. 54 (1892); Kean v. Johnson, 9 N.J. Eq. 401 (1853); see Geddes v. Anaconda Mining Co., 254 U.S. 590 (1921); see also Fain, Limitations of the Statutory Power of Majority Stockholders to Dissolve a Corporation, 25 Harv. L. Rev. 677, 678 (1912).

[4] Geddes v. Anaconda Copper Mining Co., 254 U.S. 590, 596 (1921).

[5] Beidenhopf v. Des Moines Life Ins. Co., 160 Iowa 629, 142 N.W. 434 (1913); Bowditch v. Jackson Co., 76 N.H. 351, 82 Atl. 1014 (1912); S.E.C., Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees, pt. 7, at 559 (1938).

[6] Such statutes have been passed in every state but one. Hornstein, op. cit. supra note 1, at 65.

[7] Investment Trusts and Investment Companies, Report of the Securities and Exchange Commission, pt. 3, at 1429 (1940).

[8] The advantage of this technique is that the bulk of the assets of the subsidiary can be absorbed by the parent without affording the minority stockholders of either corporation an opportunity for the appraisal of their shares, as would usually result in either a technical merger or consolidation. Ibid.

[9] Allied Chemical & Dye Corp. v. Steel & Tube Co., 14 Del. Ch. 1, 120 Atl. 486 (1923); Wall v. Anaconda Copper Mining Co., 216 Fed. 242 (D.C. Mont. 1914); Windmuller v. Standard Distilling & Distributing Co., 114 Fed. 491 (C.C.N.J. 1902). See Allaun v. Consolidated Oil Co., 16 Del. Ch. 318, 325, 147 Atl. 257, 261 (1929), where the court in discussing the related problem of the sale of the entire assets of a corporation said that the majority stockholders were to be given the presumption of good faith and fairness, and only if the disparity between the sales price and the value of the assets was great enough to indicate that it arose from improper motives or reckless indifference on the part of the majority stockholders, rather than from an honest mistake in business judgment, would a proposed sale be upset.

tionship to the minority is often enunciated in the cases, it seldom has been applied to the action of the majority in bringing about dissolution.[10] It is only under statutes such as that of New York, which requires that the dissolution be "advisable," that the courts have required majority stockholders to consider the "corporate good" above their own personal interests in deciding whether the corporation should be dissolved.[11] The statutes in most states, West Virginia among them, apparently give the specified percentage of the stockholders the absolute right to dissolve the corporation without regard to the interests of the minority.[12] Similar statutes providing for the sale of the entire assets of a corporation by a majority vote have been interpreted in the same way.[13] In the *Allied Chemical* case[14] the Delaware court said, "the bald question of whether the entire assets should be sold is to be determined by the stockholders entirely aside from the question of whether it would be to the best interests of the corporation to sell them."

The same court distinguished, however, between the power of the majority stockholders to sell the assets, and the power to fix the terms and conditions of the sale.[15] It is well established that the majority stockholders, in selling the corporate assets to themselves, do not by that action alone violate any fiduciary duty to the minority.[16] That they do violate such an obligation, if they sell the assets to themselves at an unfair price, is also well established.[17]

[10] In those cases in which a dissolution was set aside or damages awarded for breach of fiduciary duty, the breach has almost always been in the sale of the corporate assets at an unfair price. Southern Pacific Co. v. Bogert, 250 U.S. 483 (1919); Nave-McCord Mercantile Co. v. Ranney, 29 F. (2d) 383 (C.C.A. 8th 1928); Hyams v. Calumet & Hecla Mining Co., 221 Fed. 529 (C.C.A. 6th 1915); Jones v. Missouri-Edison Electric Co., 144 Fed. 765 (C.C.A. 8th 1906); Ervin v. Oregon Ry. & Nav. Co., 27 Fed. 625 (C.C.N.Y. 1886); see S.E.C., Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees, pt. 7, at 584 (1938).

[11] Kavanaugh v. Kavanaugh Knitting Co., 226 N.Y. 185, 123 N.E. 148 (1919). For interpretations of similar statutes see Paine v. Saulsbury, 200 Mich. 58, 166 N.W. 1036 (1918); White v. Kincaid, 149 N.C. 415, 63 S.E. 109 (1908).

[12] Hornstein, op. cit. supra note 1, at 66.

[13] Allaun v. Consolidated Oil Co., 16 Del. Ch. 318, 147 Atl. 257 (1929); Nave-McCord Mercantile Co. v. Ranney, 29 F. (2d) 383 (C.C.A. 8th 1928); Allied Chemical & Dye Corp. v. Steel & Tube Co., 14 Del. Ch. 1, 120 Atl. 486 (1923). One court in speaking of the power to sell the corporate assets under such a statute said that "motive, vendee, price, consideration are all immaterial, provided the transaction be free from fraud." Wall v. Anaconda Copper Mining Co., 216 Fed. 242, 244 (D.C. Mont. 1914).

[14] 14 Del. Ch. 1, 11, 120 Atl. 486, 490 (1923).

[15] Ibid., at 11–12, 491. This distinction is severely criticized in 2 Bonbright, Valuation of Property 814–15 (1937) where it is pointed out that the power to sell the corporate assets can only be tested in terms of the price and conditions fixed by the majority, and cannot be separated from the power to determine the conditions of the sale.

[16] See cases cited in note 9 supra.

[17] Note 10 supra. In S.E.C., Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees, pt. 7, at 586 (1938), doubt is indicated that the Delaware courts would pursue the distinction between the power to

It was this principle which the court considered applicable under its interpretation of the facts in the *Inland* case. Although the price paid for the physical assets was admittedly fair, yet, according to the court, that price did not include the value of good will belonging to the subsidiary. Thus the minority stockholders were held to be entitled to their share of the going concern value of the business. Since the court held, however, that the power of the majority stockholder to dissolve the corporation would not be restricted, it might be argued that it had the power to deprive minority stockholders of their share of the good will, since by dissolution the good will is necessarily extinguished. To this the court answered that while the majority stockholder might if it chose extinguish the good will, it did not have the right to appropriate it. This answer seems sound both on principle and as a matter of policy. The complex structure of our legal and economic systems may require that majorities, in determining whether an enterprise is to be liquidated or reorganized, be allowed to pursue their "enlightened self interest." On the other hand, justice requires that minority interests be protected from schemes of majority stockholders to enrich themselves at the minority's expense.

Unfortunately, the court in the Inland cases failed properly to interpret the facts to which these principles were applied. The court failed to see that, in the light of the peculiar history of this parent-subsidiary relationship, no appropriation of good will was apparently involved. The history is worth sketching in some detail.

Inland Steel Company had been founded in 1893. In 1911, N. F. Leopold, father of the plaintiffs and brother-in-law of P. D. Block, president of Inland Steel, proposed the organization of a steamship company, with the steel company as majority stockholder, for the purpose of hauling the steel company's raw materials from their various locations on the Great Lakes to Inland's hearths at Indiana Harbor. The Inland Steamship Company was accordingly incorporated under the laws of West Virginia. Sixteen hundred shares of capital stock were issued, of the par value of $100 each. Until 1935, 67½ per cent of these shares were owned by the steel company, 18 per cent by Mr. Leopold, and the remainder by employees or business associates of the steel company. Since 1911, P. D. Block had been the president of the steamship company as well as of the steel company, and a majority of the board of directors of the steamship company had always been composed of directors and employees of the steel company.

sell and the terms of the sale to the conclusion just reached. The doubt is based on a dictum in Allaun v. Consolidated Oil Co., 10 Del. Ch. 318, 147 Atl. 257 (1929), that if the sole purpose of the sale is to freeze out the minority stockholders, it may be enjoined. This dictum is discordant with the whole tone of the case, whose holding was, that a sale by the majority stockholders for the purpose of forcing the corporation to pay debts it owed them is not to be enjoined for that reason alone. In the event that a case should arise in which the price paid for the assets was fair, even though the minority were frozen out, the Delaware court would probably not set aside the sale.

The operations of the steamship company were remarkably successful. The figures for the years 1925 to 1934 indicate that the average annual earnings during that period were $134 per share and the average annual dividends $103 per share. As already stated, the shares were of $100 par value and presumably represented an investment of no larger amount. The sole basis for these huge earnings was the tonnage transported for the steel company which was the sole customer of its subsidiary. The court found that there never had been a contract concerning rates or requiring the steel company to give its traffic to the steamship company. The rates paid by the steel company are referred to as "going rates" and in the first opinion the court spoke of them as "prevailing market rates." As the source of the steamship company's large earnings and thus of the alleged good will, these rates are of greatest importance. It can hardly be true that they represented competitive or "going" rates which a steel company like Inland would have to pay if it contracted for the bulk of its tonnage with an independent fleet owner. The rates paid may, of course, represent a market rate for the company's excess tonnage in periods of peak demand.[18]

At the annual meeting of the steamship company in December, 1934, Mr. Block stated that the steel company desired to purchase the minority interests. A committee was thereupon appointed to fix the value of the ships. Its report was submitted the following May, stating that inasmuch as the steel company had indicated its unwillingness to continue placing its business with the steamship company on the terms theretofore in effect, it recommended the purchase of the minority stock at a price of $700 per share. It did not report on the value of the ships, but the price fixed for the shares reflected a valuation of corporate assets at $1,030,000.[19] The price was fixed by the vice-president of both the steel and steamship companies, who candidly stated that if the minority stockholders did not sell at $700 per share, the steel company, as majority stockholder, would dissolve the steamship company, sell its ships, and distribute the proceeds. He further stated that in order to protect its investment the steel company would bid enough at the sale to realize $700 per share, but that if a better bid should be made it would be accepted.

The plaintiffs objected to selling at that price, calling attention to the fact that on the basis of capitalized earnings their stock was worth close to $2000 per share. The steel company refused to submit the value of the shares to arbitration, and gave notice of a special meeting of the stockholders to consider dissolution. Thereupon, the plaintiffs filed suit to restrain the proposed dissolution. The district court held that the dissolution should not be enjoined; that in fixing the value of the stock the past record of earnings should not be considered; that the offer was fair, and that if it should be assumed that the steel com-

[18] The rate at which the subsidiary was paid for transporting the bulk of the steel company's tonnage was the same as the rate at which the excess tonnage was transported by the independent Premier Steamship Company.

[19] This figure is probably an error in the record since it represents somewhat less than $700 per share and is less than the $1,120,000 actually paid for the ships; see note 22 infra.

pany intended to terminate its traffic arrangement with its subsidiary, it would be for the best interests of the stockholders to dissolve the company.

On appeal, the circuit court held that the plaintiffs' action was premature, invoking the first of the principles discussed above, that under the controlling statute dissolution might be voted regardless of motive or expediency.[20] It also asserted, however, that in the disposition of the corporate assets the majority stockholders owe a fiduciary duty to the minority and may derive no benefit at their expense, and that, in the determination of the value of the minority interest, among the things to be considered are "cost of physical assets, ... market price, earnings, the chances of future successful operation, and the prospects of continued earnings."[21] Specifically, the district judge was said to have erred in approving the $700 valuation because he ruled that the earnings record could not be considered. Thus the decision of the circuit court of appeals was, at the same time, an affirmation of the holding of the district court and a denial of most of its findings and inferences.

In the meantime, the affairs of the steamship company had proceeded with the usual success, a dividend of $150 per share having been declared for 1935. Eight days after the decision of the court, notice was given of a stockholders' meeting to consider the matter of dissolution. At the meeting a resolution was adopted calling for the dissolution of the steamship company and the sale of its assets. At the public sale that followed, the ships were purchased by the steel company for $1,120,000, a price that admittedly represented their fair value. In the ensuing distribution, the stockholders received a total of $604.17 per share.[22] The ships were immediately put into service by the steel company performing exactly the same function as heretofore.

The minority stockholders again brought suit in the district court, this time for damages for alleged fraudulent acts of the steel company in so utilizing its position as to force the steamship company out of a prosperous going business and appropriate its business at the expense of the minority stockholders. The district court again dismissed the action. The decision of the appellate court has already been stated. Emphasizing that the apparent purpose of the dissolution was to eliminate the minority stockholders, it reversed the district court and held that, although the steel company was within its statutory rights in forcing a dissolution, "no legislative enactment could endow them [the steel company officers] with the right as trustees for the minority stockholders to take over for their own . . . . all assets and all business of the company for which they were fiduciaries, if to do so was clearly and obviously against the best interests of the company and the minority stockholders."[23] The court further said that, "the so-called dissolution was a mere device by means of which defendant ap-

[20] Lebold v. Inland S. S. Co., 82 F. (2d) 351, 353 (C.C.A. 7th 1936). [21] Ibid., at 356.

[22] The purchase price, $1,120,000, is equal to the cost of 1000 shares at $700 per share. The actual price per share received, $604.17, was lower because of deductions for taxes and the expenses of the public sale.

[23] Lebold v. Inland Steel Co., 125 F. (2d) 369, 372 (C.C.A. 7th 1941), cert. den. 62 S. Ct. 1045 (1942).

propriated for itself the transportation business of the Steamship Company to the detriment of plaintiffs."[24] The measure of damages was held to be the difference between what the plaintiffs had received and "what the stock was really worth as stock in a going prosperous concern continuing in business."[25]

The court noted that evidence of both parties indicated that "if the Steamship Company had been considered a going concern and *if its business might reasonably be expected to continue*, the value of plaintiffs' stock would be in the neighborhood of $2000 per share."[26] The whole question, of course, is whether the business might reasonably be expected to continue. To begin with, nowhere does the court say that Inland, once having placed traffic with the subsidiary, is bound to do so indefinitely. If it is not bound, the parent would not seem to have appropriated any good will or going concern value whatever. Furthermore, it should be apparent that the huge earnings of the steamship company could not possibly continue even if there had been no dissolution. Annual earnings of 150 per cent of the original capital investment, made over a period of 25 years, and all made from business furnished by a single customer, suggest that the customer has been overpaying for the service it is getting. At the trial the minority stockholders admitted that the so-called "going rates" were too high and that lower rates could be obtained by the steel company. However we regard the action of the steel company in having enormously enriched its subsidiary, it would certainly not have been a breach of fiduciary duty to cease pouring "a golden stream to the minority stockholders."[27]

The steel company could certainly have renegotiated rates, and without unfairness to the subsidiary could have reduced its returns to a very moderate rate. If, after continuing at the new rate for a number of years, the majority stockholders should then have voted dissolution, even if the capitalized earnings were taken as the measure of value, it would have supported a valuation of little, if anything, more than the value of the physical assets. If dissolution could be accomplished under these circumstances with payment to the minority of only its pro rata share of the proceeds of the physical assets, it would seem that there is no basis for the court's insistence that in the principal case the minority have been deprived of any intangible values.

To be sure, in some cases it may appear unfair that dissolution should be used to expel minority stockholders who have shared the risk during the early years of the corporation.[28] The objection has force even though the minority is paid for its share of all intangible values; for the minority may prefer to remain in the enterprise. It is rather surprising that there is not more authority supporting the view that even under statutes of the West Virginia type, dissolution refers to complete liquidation or to sale to an outsider, and that the dissolution

[24] Ibid., at 373.

[25] Ibid., at 375.

[26] Ibid. (italics added).

[27] Lebold v. Inland S. S. Co., 82 F. (2d) 352, 353 (1936).

[28] Theis v. Spokane Falls Gas Light Co., 34 Wash. 23, 74 Pac. 1004 (1904).

section may not be used to accomplish what is in effect a merger.[29] If the merger device had been used here, and if the dissenters had elected to take the appraised value of their shares, a question of valuation would be raised, of course, similar to the question involved in the principal case.[30]

The case has been remanded to the district court for the determination of damages in accordance with the opinion of the appellate court. This will be found to be no easy task. It is not impossible that the difficulties may lead the district court to find that the value of the minority's stock in this "going prosperous concern" is actually no more than their proportionate share of the value of the physical assets. In that event, if the district court should make findings adequately analyzing the source of the steamship company's earnings, it should not be impossible to induce the appellate court to sustain the decision.

PROHIBITIONS AGAINST MULTIPLE STATE INHERITANCE TAXATION OF INTANGIBLES REMOVED*

The State Tax Commission of Utah taxed[1] shares of stock of a Utah corporation that were transferred at the death of a New York domiciliary. In a proceeding before the trial court the administrator's contention that the inheritance tax was invalid under the holding of *First National Bank of Boston v. Maine*[2] was sustained. The Supreme Court of Utah upheld the trial court,[3] specifying that

[29] The holding of the Inland decision might be construed to support this distinction since there is language in the case that implies that the so-called dissolution was a weak device by means of which the majority stockholder appropriated the transportation business of its subsidiary. If this is the true construction to be put on the opinion, however, it is difficult to reconcile it with the previous decision in which the steel company was permitted to proceed with its plans to dissolve the subsidiary and purchase its assets; cf. Allaun v. Consolidated Oil Co., 16 Del. Ch. 318, 147 Atl. 257 (1929); In re Doe Run Lead Co., 283 Mo. 646, 223 S.W. 600 (1920); Theis v. Spokane Falls Gas Light Co., 34 Wash. 23, 74 Pac. 1004 (1904).

[30] See Lattin, Remedies of Dissenting Stockholders under Appraisal Statutes, 45 Harv. L. Rev. 233 (1931); Levy, Rights of Dissenting Shareholders to Appraisal and Payment, 15 Corn. L. Q. 420 (1930).

* State Tax Com'n of Utah v. Aldrich, 316 U.S. 174 (1942).

[1] Utah Rev. Stat. Ann. (1933) §§ 80–12–2, 80–12–3.

[2] 284 U.S. 312 (1932). The Court held invalid under the Fourteenth Amendment the attempt by Maine, the state of incorporation as well as the situs of the corporate property, to tax the transfer-by-death of shares of stock owned by a Massachusetts domiciliary. Massachusetts had taxed the transfer as the state of domicile of the shareholder. This ruling was the culmination of the outlawing of double taxation of intangibles which was begun in 1930 in Farmers Loan and Trust Co. v. Minnesota, 280 U.S. 204 (1930), and continued in Baldwin v. Missouri, 281 U.S. 586 (1930), and Beidler v. South Carolina Tax Com'n, 282 U.S. 1 (1930).

[3] 116 P. (2d) 923 (Utah, 1941).