

15.3: Dissolution

Learning Objectives

By the end of this section, you will be able to:

- Define and distinguish dissolution and liquidation.
- Discuss the different types of dissolution and liquidation.
- Discuss claims against a dissolved corporation.

Dissolution is the end of the legal existence of the corporation, basically “corporate death.” It is not the same as liquidation, which is the process of paying the creditors and distributing the assets. Until dissolved, a corporation endures, despite the vicissitudes of the economy or the corporation’s internal affairs. As Justice Cardozo said while serving as chief judge of the New York court of appeals: “Neither bankruptcy...nor cessation of business...nor dispersion of stockholders, nor the absence of directors...nor all combined, will avail without more to stifle the breath of juristic personality. The corporation abides as an ideal creation, impervious to the shocks of these temporal vicissitudes. Not even the sequestration of the assets at the hands of a receiver will terminate its being.” *Petrogradsky Mejdunarodny Kommerchesky Bank v. National City Bank*, 170 N.E. 479, 482 (N.Y. 1930).

See www.irs.gov/businesses/small/article/0,,id=98703,00.html for the Internal Revenue Service’s checklist of closing and dissolving a business. State and local government regulations may also apply.

Voluntary Dissolution

Any corporation may be dissolved with the unanimous written consent of the shareholders; this is a voluntary dissolution. This provision is obviously applicable primarily to closely held corporations. Dissolution can also be accomplished even if some shareholders dissent. The directors must first adopt a resolution by majority vote recommending the dissolution. The shareholders must then have an opportunity to vote on the resolution at a meeting after being notified of its purpose. A majority of the outstanding voting shares is necessary to carry the resolution. Although this procedure is most often used when a company has been inactive, nothing bars its use by large corporations. In 1979, UV Industries, 357th on the *Fortune* 500 list, with profits of \$40 million annually, voted to dissolve and to distribute some \$500 million to its stockholders, in part as a means of fending off a hostile takeover. *Fortune* magazine referred to it as “a company that’s worth more dead than alive.” *Fortune*, February 26, 1979, 42–44.

Once dissolution has been approved, the corporation may dissolve by filing a certificate or articles of dissolution with the secretary of state. The certificate may be filed as the corporation begins to wind up its affairs or at any time thereafter. The process of winding up is liquidation. The company must notify all creditors of its intention to liquidate. It must collect and dispose of its assets, discharge all obligations, and distribute any remainder to its stockholders.

Involuntary Dissolution

In certain cases, a corporation can face involuntary dissolution. A state may bring an action to dissolve a corporation on one of five grounds: failure to file an annual report or pay taxes, fraud in procuring incorporation, exceeding or abusing authority conferred, failure for thirty days to appoint and maintain a registered agent, and failure to notify the state of a change of registered office or agent. State-specific differences exist as well. Delaware permits its attorney general to involuntarily dissolve a corporation for abuse, misuse, or nonuse of corporate powers, privileges, or franchise. Del. Code Ann. tit. 8, § 282 (2011). California, on the other hand, permits involuntary dissolution for abandonment of a business, board deadlocks, internal strife and deadlocked shareholders, mismanagement, fraud or abuse of authority, expiration of term of corporation, or protection of a complaining shareholder if there are fewer than thirty-five shareholders. Cal. Corp. Code § 1800 et seq. (West 2011). California permits the initiation of involuntary dissolution by either half of the directors in office or by a third of shareholders.

Judicial Liquidation

Action by Shareholder

A shareholder may file suit to have a court dissolve the company on a showing that the company is being irreparably injured because the directors are deadlocked in the management of corporate affairs and the shareholders cannot break the deadlock.

Shareholders may also sue for liquidation if corporate assets are being misapplied or wasted, or if directors or those in control are acting illegally, oppressively, or fraudulently.

Claims against a Dissolved Corporation

Under Sections 14.06 and 14.07 of the Revised Model Business Corporation Act, a dissolved corporation must provide written notice of the dissolution to its creditors. The notice must state a deadline, which must be at least 120 days after the notice, for receipt of creditors' claims. Claims not received by the deadline are barred. The corporation may also publish a notice of the dissolution in a local newspaper. Creditors who do not receive written notice or whose claim is not acted on have five years to file suit against the corporation. If the corporate assets have been distributed, shareholders are personally liable, although the liability may not exceed the assets received at liquidation.

Bankruptcy

As an alternative to dissolution, a corporation in financial trouble may look to federal bankruptcy law for relief. A corporation may use liquidation proceedings under Chapter 7 of the Bankruptcy Reform Act or may be reorganized under Chapter 11 of the act. Both remedies are discussed in detail in Chapter 13.

Key Takeaway

Dissolution is the end of the legal existence of a corporation. It usually occurs after liquidation, which is the process of paying debts and distributing assets. There are several methods by which a corporation may be dissolved. The first is voluntary dissolution, which is an elective decision to dissolve the entity. A second is involuntary dissolution, which occurs upon the happening of statute-specific events such as a failure to pay taxes. Last, a corporation may be dissolved judicially, either by shareholder or creditor lawsuit. A dissolved corporation must provide notice to its creditors of upcoming dissolution.

Exercises

1. What are the main types of dissolution?
2. What is the difference between dissolution and liquidation?
3. What are the rights of a stockholder to move for dissolution?

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