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OPPRESSION OF MINORITY SHAREHOLDERS IN CLOSE CORPORATIONS: THE DISSOLUTION AND BUY OUT REMEDIES

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Chapter I. Introduction

"There are 51 shares that are worth $250,000. There are 49 shares that are not worth a - -."  

For years this typified the situation of oppressed minority shares in close corporations. To understand the potential dramatic consequences of oppression in close corporation it is in first instance necessary, to outline the specific characteristics of these corporations. The first chapter concentrates on the peculiarities of close corporations. Close corporations differ from public corporations. There is no market available for their shares. the shareholders have greater expectations of participation than shareholders of public corporations and the relationship between the shareholders is close if not intimate. It appeared in an early period that the legal corporate framework tailored to the needs of public corporations did not meet those of close corporations. Some tried to introduce the necessary flexibility by analogizing close corporations with partnerships. Although these legal entities share some common characteristics, the analogy is not wholly satisfactory. Thus, the legislatures intervened by enacting a few special close corporate provisions or complete close corporate supplements to the existing corporate law. In parallel, the flexibility of general corporate statute was increased. This first step tempered the curse of the "49 shares" minority shareholder. The protection provided consists mainly of the right to draft adapted shareholders agreements. However, the great majority of shareholders is not capable or willing to bargain for such protection. This unwillingness is paradoxically caused by the special relationships existing within close corporations and by a efficiency

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1 Humphrys v. Winous Co., 133 N.E.2d 780, 783 (Ohio 1956)
v. transaction cost analysis. The most common agreements are briefly cited in the last chapter. Other protective provisions are unavailable because shareholders often do not elect for close corporate statute.

Traditional corporate norms, like the majority rule and the business judgment rule allowed majority shareholders to use a wide range of oppression techniques in almost complete impunity. However, judicial interpretation of new statutory protections would open the way to redress the balance between majority and minority shareholders. In fact, three interlinked factors evolving in parallel deeply changed the position of minority shareholders in close corporations. Those are 1) The broadening interpretation of “oppression” by the judiciary 2) The increasing willingness to dissolve close corporations or order a buy out of the shares of the minority 3) Willingness, encouraged by the enactment of less drastic alternative remedies.

Most states enacted “oppression” as a generic ground for remedial action. Previously, it was necessary to attack every oppression technique by a remedy available for the specific technique. It was burdensome to resist a complete scheme of oppression. While provisions allowing far reaching shareholders agreement partially failed, the enactment of oppression statutes proved successful. This success was boosted by the ever broader interpretation courts gave to “oppression”. In a first faze courts used a fault based criteria but rapidly they switched to the reasonable expectation standard. A standard specifically developed for close corporation participants. The second chapter evaluates the different standards emphasizing reasonable expectations. Reasonable expectations if properly limited appears to be an efficient tool to measure oppression.

In other jurisdictions, mainly where oppression is not available as a ground for dissolution, courts encountered the needs of close corporations by enhancing the owed fiduciary duties. Thus, in some jurisdiction two cause of action developed, one for oppression measured by a frustration of reasonable expectations and one for breach of
fiduciary duties. When "oppression" is available as ground for relief, fiduciary duties often overlap unnecessarily. Sometimes they supplement the available protection. If oppression is not available they are indispensable as only generic ground for protection.

Courts recognized, often out of fiduciary duty actions, the right of direct claim. Derivative claims are required in many oppression cases. This appears to be absurd in most cases. Derivative action destroys the hope to get an effective relief because the majority is in control of the corporation to whom the relief will be awarded. The development of direct actions for traditionally derivative claims is of tremendous importance.

When in close corporations disagreement is deeply rooted and communication has broken down, definitive remedies are necessary. This is why slowly courts and statutes have accepted that minority shareholders petition for involuntary dissolution. The remedy destroys one of the main characteristics of corporations: permanence! This dissolution remedy must therefore cautiously be evaluated as a remedy. It is not evident that minority shareholders (even those who have been systematically oppressed) have the right to impose such strain on the majority. Protection of minority cannot blind us from the inherent rights of the majority. Right to control a corporation, define corporate policies and certainly right not to be deprived of a going concern business. Moreover, to much power to the minority is a cause of increasing deadlock and dissension. However a corporation ridden by dissension does not serve anybody, minority nor majority. Withdrawal must be organized.

Less drastic is the buy out remedy. Where (majority) shareholders buy the "oppressed" shares. The remedy was initially meant to be an alternative to a requested dissolution. Later on it could be requested directly to escape oppression without any reference to dissolution. The remedy is still severe. The financial consequences can be devastating for the corporations or the majority. It is not a panacea. The procedures are
complex and valuation often arbitrary. This thesis, while advising that buy out should be used sparingly, advocates a broader acceptance of the buy out remedy. Nobody can force an abused shareholder’s investment to remain locked in a corporation. Minority have to share the risks of the enterprise, however, not to an extent that includes oppression by the majority. Direct action to be bought out provide such remedy without the necessity to have the corporation liquidated. Buy out is the ultimate solution for the illiquidity problem of close corporations.

With the buy out remedy a whole list of alternatives where developed to help solve dissension. Most of those remedies, while seemingly less drastic, do not provide effective solution for serious dissension. Their ad-hoc character transform obtained relief in a pyrrhic victory. The minority stays locked in and waits for the next judicial battle.

The three evolutions described above supported by adapted statutory close corporate provisions, allow to conclude that minority shareholders are not longer helpless in close corporations. Nowadays, 49 shares are worth a bit, although a precise valuation is illusory. This is the eternal plight of the minority.
Chapter II. Close Corporations

A. Definition

A close corporation is a corporation "whose shares are not generally traded in the securities market". This means that the stock is neither listed on any stock exchange nor traded on an over-the-counter market. Basically, the close corporation has no market for its shares.

Close corporations however, is a vague concept that can not be grasped by this narrow definition. A definition focussing only on the lack of market does not encompass the diversity of the close corporation characteristics. This is why other definitions sum a list of the main characteristics of close corporations.

In Donahue v. Rodd Electrotype Co., one of the first case recognizing rights of minority shareholders in close corporations, the Supreme Judicial Court of Massachusetts "deemed a close corporation to be typified by: (1) a small number of stockholders; (2) no ready market for the corporate stock; (3) substantial majority stockholder participation in the management, direction and operations of the corporation."

Commentators are more expansive. They list following close corporations characteristics: (1) the shareholders are few (2) they usually live in the same geographical

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2F. HODGE O'NEAL & ROBERT B. THOMPSON, O'NEAL'S CLOSE CORPORATIONS§ 1.02 (3d ed. 1988) [hereinafter O'NEAL'S, CLOSE CORPORATIONS] (Professor O'Neal is "the" leading authority in close corporations, this thesis as every article concerning close corporations or shareholder oppression relies often on professor O'Neal's treatise)


4 367 Mass. 578, 328 N.E.2d 505 (1975)
area and know each other well (3) management and ownership are substantially identical. Hence, most shareholders participate actively in the business. Usually, they serve as directors, officers or fulfill other managerial functions. The firm has very few managers (4) Shareholders treat each other as partners (5) there is no market for the shares. Little or no trading at all of shares takes place\(^5\).

As it appears from the enumeration above the second most important attributes of close corporations, besides the lack of market, are the close relations among shareholders and the identity between management and ownership. Other definitions of close corporations give more weight to this relational aspect. Carlos D. Israels defines close corporations as "an enterprise in corporate form in which management and ownership are substantially identical\(^6\). Finally, some definitions include both characteristics. the lack of market as well as the tied relationships\(^7\).

For a long time close corporations were only defined by scholars and courts. This changed with the adoption of close corporations statutes. The model statutory close corporation supplement of 1982 (hereafter, the "supplement") provides that "corporation

\(^5\) O’NEAL’S, CLOSE CORPORATIONS, supra note 2 at §1.02, 1.08; Frank H. Easterbrook & Daniel R. Fischel, Close corporations and agency costs, 38 Stan. L. Rev. 271, 273 (1986) [Hereinafter Easterbrook, Agency cost](This article has also been published in the new book of Easterbrook and Fischel under the chapter close corporations. Both are cited indifferently in this thesis. See FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW, 228-252 (1991)[hereinafter EASTERBROOK’S, CORPORATE LAW]; Don Berger, Statutory Close or Closely Held Corporations?, 11 PAC. L. J. 699 (1980)

\(^6\) Carlos D. Israels, The Close Corporations and the law, 33 Cornell L. Q. 488 (1948)[hereinafter Israels, Close corporations] (Israels is one of the first scholars to draw the attention of the legal community on the close corporation problem and to plead for the partnership analogy. Concerning the definition of close corporations he noted that “no satisfactory all purpose definition of a close corporation appears ever to have been worked out”); The BLACK’S LAW DICTIONARY (6th ed. 1990) (defines close corporations; "A corporation whose shares, or at least voting shares, are held by a single shareholder or closely-knit group of shareholders. Generally, there are no public investors and its shareholders are active in the conduct of the business....")

\(^7\) See American Law Institute, Principles of Corporate Governance: Analysis and Recommendations §1.06 (1994)(“Closely held corporation means a corporation the equity securities of which are owned by a small number of persons, and for which no active trading market exists.”)
having 50 or fewer shareholders may become statutory close corporations"\(^8\). The corporation elects to become a statutory close corporation by including in its articles of incorporation an explicit statement that the corporation is a "statutory close corporation"\(^9\). This definition emphasizes the small number of shareholders aspect, without mentioning the absence of market. (Infra. I.C. for a discussion of this heavily criticized definition and the eligibility requirements). Economics, are not neglected in all statutory definitions. For instance New York and Ohio invalidate shareholders agreements once the shares of the corporations are traded on the securities market\(^{10}\). In other statutes it suffices to show an intent by electing to become a close corporation. There are no other restrictions or eligibility requirement whatsoever\(^{11}\). Finally, some states do not recognize close corporations as a form legally distinct from other corporations\(^{12}\).

The terms “closed” “close” or “closely held” corporations are interchangeable. “Closed” emphasizes the willingness to keep outsiders out of the corporations by not allowing them to become investors. “Closely held” on its turn focuses on the small number of shareholders and their special relationship\(^{13}\). As does the term "incorporated partnership" used by proponents of the partnership analogy\(^{14}\). Others distinguish between


\(^9\) Model Stat. Close Corp. Supp. § 3(a). (Comment 2) (European legislation distinguishes between private and public corporations in the companies’ name. The American system does not make such a differentiation)

\(^10\) N.Y. Business Corp. Law § 620(c) (McKinney 1996); Ohio Rev. Code Ann. §17101.591(1) (Anderson 1996) (a close corporation may not have his shares listed on a national securities exchange or regularly quoted in the over-the-counter market)


\(^12\) Michigan recognized close corporations and has a very liberal statute. Michigan corporate statutes states Mich. Comp. Laws. § 450.1103 that “This act shall be liberally construed and applied to promote its underlying policies which include all of the following: ...(c) To give special recognition to the legitimate needs of close corporations” and at § 450.1489 (the possibility to request buy out for corporations for shares not listed on a national securities exchange).

\(^13\) O’NEAL’S, CLOSE CORPORATIONS, supra note 2 at § 1.04

the statutory defined "close" corporations and the judicially defined "closely held" corporations\textsuperscript{15}. This paper discusses both, the judicially and statutorily defined close corporations.

There are also many different types of close corporations. The non-archetypical and the archetypical close corporation\textsuperscript{16}. The latter refers to the small company where shareholders have familial or other personal relations. Some authors distinguish close corporations who are owner-managed from those who are not\textsuperscript{17}.

The size of the close corporations is not determinative. While most are small enterprises some are corporate giants worth millions of dollars. However, both encounter the same problems typical of close corporations\textsuperscript{18}.

The economic importance of close corporations is huge. Most of the businesses in the United States are close corporations from which ninety-five percent are family owned\textsuperscript{19}.

We conclude that the essence of the close corporation problem is the lack of market\textsuperscript{20}. The basis for the power of the majority rests on the inability of the minority to withdraw from the corporations\textsuperscript{21}. Thus it is this feature that determines the other

\textsuperscript{15} Gary D. Justis, Comment, Avoiding a minority shareholder oppression claim in a close corporation in Missouri: the impact of the new close corporation statutes, 56 Mo. L. Rev. 257, 263 (1991)

\textsuperscript{16} See Charles R. O'Kelley, Jr., Commentary, Filling gaps in the close corporations contract: a transaction cost analysis, 87 Nw. U. L. Rev. 216, 238 (1992) (using the distinction between archetypical and non archetypical close corporations to analyze their needs in adaptability opportunism and thus their needs for stability and limited liability or for the partnership law relationship)

\textsuperscript{17} Terry A. O'Neill, Self interest and concern in the owner-managed firm: a suggested approach to dissolution and fiduciary obligation in close corporations, 22 Seton Hall L. Rev. 646 (1992)

\textsuperscript{18} O’NEAL’S, CLOSE CORPORATIONS, supra note 2 at § 1.03; Carlos D. Israels, The sacred cow of corporate existence. problems of deadlock and dissolution, 19 U. Chi. L. Rev. 778 (1952) [hereinafter Israels, Sacred cow]


\textsuperscript{20} O’NEAL’S, CLOSE CORPORATIONS, supra note 2 at § 1.02

\textsuperscript{21} J.A.C. Hetherington, Special characteristics, problems, and needs of the close corporation, U. Ill. L. Forum 1, 21 (1969)[hereinafter Hetherington, Needs of close corporations]
problems arising in close corporations more than any other characteristic. Therefore, we adhere to Professor O'Neal's "lack of market" definition of a close corporation.

B. Specificities of close corporations

1. Public corporations v. Close corporations

a. Ownership and control

The classical theory of agency cost as set forward in the 30's by Berle and Means points out that the main problem of corporations is the separation of ownership and control\(^{22}\). Traditional corporate norms give effect to this separation and adjudicate two different functions to shareholders and directors. While the first provide the capital necessary for the corporation, the second manages this investment\(^{23}\). The same duality does not exist in most close corporations\(^{24}\). In public corporations, the fear is that the management will act in its own interest and neglect that of the owner-shareholders. Since, shareholders posses only an infinite part of the corporation, they act as passive investors\(^{25}\). It is not interesting for them, rational investors, to spend much time reading

\(^{22}\)ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY, (1933)


\(^{25}\)O'Neill supra note 17 at 663; See also O'Kelley, supra note 16 at 216 (observing that a simple dichotomy between close and public corporation distorts reality. There is in fact a continuum of jointly owned firms. This observation is correct however it does not invalidate the analyze of the differences between the two types of corporations)
information about their corporation. It is certainly not worth to try to stip out management
policy for the corporation. When displeased by the management, they will not try and
cannot correct the policies. This would be time consuming, instead they sell their shares.
Giving effect to the so called "wall street rule".

Traditional corporate norms are looking for mechanism guaranteeing that managers
will act in shareholders best interest. Rules like free transferability of shares, independent
directors, rules of conduct for directors and other monitoring rules reflect these
concerns. Thus corporate regulations are tailored to protect the weak part of the
equation, the shareholders against the management.

In close corporation there is virtually no agency cost problem because management
and ownership is identical. However a different problem of representation arises. The
majority shareholders do not have to take the interests of the minority into account.
Therefore, regardless of the minimized agency cost risks some scholars believe minority
shareholders in close corporations face "unique" risks of oppression. Its fair to
conclude, based on the different economical and agency structures of close corporations,
that adapted rules should try to meet their specific needs.

27 Easterbrook, Agency cost, supra note 5 at 278; See O'Neill supra note 17 at 665-666 (Other rules of
monitoring are the rights to inspect corporate books and records, the obligation to make public some results
an activities, the rules that refrain the use of anti take-over measures)
28 Many European countries like Germany, Belgium do not face the same problem. The biggest
corporations are privately owned by banks or families. The shares that traded on the stock exchange
represent only an infinite part of the total assets. Since there is no market for corporate takeovers, the
market does not play his monitoring function (See Generally Henry Mann, Mergers and the Market for
Corporate Control, 73 J. Pol. Econ. 110 (1965)) Moreover, institutional investors, have the skill time and
willingness to be active shareholders. This is a rational decision because the amount of shares they posses is
so important that they can not sell without causing turmoil on the market. They would suffer huge losses.
The problem in these public corporation is to some extent the same problem faced by shareholders in close
corporations: the risk of oppression and squeeze out. Corporate norms should reflect this concerns and
protect minority against majority and not shareholders against management. Note that for instance in the
United Kingdom this is not the case since most shares of public corporations are traded on the stock
exchange.
29 Fama & Jensen, Separation of ownership and control, 26 J.L. & Econ. 301 (1983); Hetherington &
Dooley, Illiquidity and Exploitation: A Proposed Statutory Solution to the Remaining Close Corporation
Problem, 63 Va. L. Rev. 1, 5-6 (1977)[hereinafter, Hetherington, Illiquidity]
b. Different relationships and expectations

Usually the close corporations is formed by friends, relatives, or other business associates\(^3\). It is in this context of close relationships, trust and optimism about the future that the corporations arises. The owners will often not consult a lawyer, bargain for protective mechanisms or adapted corporate rules\(^3\). Even when they realize the risks they are often not willing to contract accordingly out of fear of scaring the other investors or altering the good relationships and the common optimism\(^3\). It is thus precisely in the context where agreements are most needed for protection that non is drawn\(^3\). From a contractual\(^3\) point of view the close corporations contract will therefore be vague and full of gaps\(^3\). Implicitly gap-filling authority is given to the majority shareholders and to the courts\(^3\).

In a public corporation shareholders expect increasing share value and some dividends. The shareholders in close corporations have greater expectations\(^3\). They often have invested a non negligible part of their assets, time and skills in the company. In

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\(^{31}\) See also Charles W. Murdock, The evolution of effective remedies for minority shareholders and its impact upon valuation of minority shares, 65 Notre Dame L. Rev. 425, 426 (1990) (". . . people enter closely-held business in the same matter they enter marriage: optimistically and ill-prepared")

\(^{32}\) Hetherington, Needs of close corporations, supra note 21 at 17-18

\(^{33}\) To some extent this is unavoidable. The corporation contract is in general a long term relational contract. Therefore the contract is necessarily incomplete. Not everything can be foreseen, many issues are not bargained for. See O'Neill, supra note 17 at 659; O'Kelley, supra note 16 at 247 (There are other reasons why parties do not contract 1) the cost of contracting might exceed the potential benefits 2) investors don't act in a fully rational way 3) a rational investor might predict that courts will exercise their equitable gap-filling authority and provide optimal governance rules and structures.)

\(^{34}\) The corporation seen as a nexus of contracts replacing the old view of the corporation as a person. See O'Neill supra note 17 at 658 (the contractarian approach is suited for close corporations. The relationships are bargained for. Otherwise the default rules apply)

\(^{35}\) O'Kelley supra note 16 at 216

\(^{36}\) Id.

\(^{37}\) O'NEAL'S, CLOSE CORPORATIONS, supra note 2 at § 1.08
return they expect employment, salary or a dividend as well as key managerial positions. As active investors they want to take part in the management of the business who often is their principal source of livelihood. Unlike in public corporations the pay off for their investment is not only monetary, but also "dignitary" (the proudness of being the boss in his own corporation) and "contenderness" (the pleasure to work with selected co-managers).

c. Illiquidity and its implications

The minority in a close corporation is in a "unique" position when it faces majority oppression. Unlike shareholders in public corporations they are not protected by the exit option offered by the securities market. The "unique" risk of oppression is thus attributed to the lack of market. Erroneously, according to some scholars, arguing that if majority shareholders have cut off every stream of revenues to the minority, the shares of the minority, even in a perfect liquid market, are not worth anything.

Illiquidity damages minority investors in various ways:

1. Valuation of shares is difficult in the absence of market. Transfers even when allowed are not easily achieved. The transaction cost of illiquid transfers is high. 2. Conflicts may soon arise concerning dividend policies and other distribution depending on the cash needs of the shareholders. Lenders will not accept illiquid shares as a collateral. 3. In the absence of hostile takeovers the market of corporate control does not play his monitoring-

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38 Thompson, Shareholder's Cause, supra note 24 at 702
40 O'Neill supra note 17 at 668-672
41 Hetherington Needs of close corporations, supra note 21 at 20; See also supra at n. 29
42 Easterbrook, Agency cost, supra note 5 at 275
43 Id. at 275-277
function role. A bad manager team will not be replaced by a better one (4) In an “uninformed” market an investor has no idea of the real price of the shares.

The absence of market should affect how court and legislatures treat close corporations.44

d. The need for adapted rules.

Traditional corporate norms are suited for corporations where ownership and control are separated. A separate corporate entity with the possibility of perpetual existence, free transferability of shares, not adapted mechanism for dissension and the strict formalistic approach45 of corporate law, do not meet the needs of close corporations actors46. There are particularly two traditional rules of corporate law who have potentially devastating effects: the majority rule and the business judgment rule47. While the majority rule can exclude the minority from the decision making process or from any involvement in the corporation the business judgment rule guarantees the discretion of these decisions and thus, the non interference of the courts. Both rules are indispensable for a healthy corporate environment. However, to the extent they lead to excess in the close corporations context they should be adapted or adaptable (Infra. III.B. for a discussion of these rules)

44 See O’NEAL’S, CLOSE CORPORATIONS, supra note 2 at § 1.08. (Emphasizing the role courts should play when invoking the business judgment rule)

45 Id. at § 1.12. 8.02

46 Thompson, dissolution, supra note 23 at 195-196

The structural differences between public and close corporations creates also a need for adapted norms in other areas of corporate law. Those areas are: 48 (1) the control of admissions to and withdrawal from the corporation (2) the control of the day to day operation (3) control over basic structural changes in legal organization or proportional interest of the participants (4) protection of employment and renumeration of individuals (5) provisions for deadlock and dissolution.

The close corporations needs in those areas must be addressed in three different ways: adapted regulations, extended contractual freedom and the possibility of withdrawal.

-Adapted regulations should for instance allow share transferability restrictions. They guarantee that the investors in the corporations can also function in the close managerial relationship with the other participants 49. On the other hand restrictions make the illiquidity problem more acute 50.

-Extended contractual liberty would allow parties to bargain for protection adapted to their needs. Buy out agreements can help address the problems of illiquidity while dividend agreements and employment agreements ensure steady streams of income 51. Parties are often not willing or able to contract (Supra. II.B.1.b ). Adapted close corporation rules should balance the need for default and mandatory protection with the need for (unfortunately underutilized) contractual freedom.

- The lack of market being the source of many, if not all, close corporation problems, involuntary dissolution and buy out should be promoted. However it can be argued that a to liberal provision increases the risk of minority abuse.

48 Hetherington, Needs of close corporations, supra note 21 at 4-5; Israels, Close corporations, supra note 6 at 492
49 O’NEAL’S, CLOSE CORPORATIONS, supra note 2 at § 1.08; Easterbrook, Agency cost, supra note 5 at 278
50 Thompson, Shareholder’s Cause, supra note 24 at 701
51 Easterbrook, Agency cost, supra note 5 at 278
The great diversity of close corporations begs the question: can it be stated that all close corporations need adapted rules? It is argued that archetypical close corporations where there is not much team specific investment, are better served by the partnership analogy while in non archetypical close corporations traditional corporate law guarantees the stability of the business

e. Conclusion

Because there is a fundamental difference in structure of ownership and control in public- and close corporation different corporate norms and standards are necessary. When commenting the contrast between the two corporate systems there is a risk of drawing the false conclusion that minority shareholders in close corporations face "unique" risks of oppression while all shareholders in public corporations face unique risks of exploitation. The risks are present in both scenarios. However they are not "unique". The different agency cost structures imply different risks. Moreover, the oppression risk is minimized by the competitive context in which many close corporation evolve. To attract talents and capital close corporations need to be credible and thus make believable promises of return on capital or labor investment.

On the other hand it can not be denied that only in the close corporation context a shareholder can be reduced to mere passive lender. When "squeezed-out" and "locked-in"

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52 See generally O'Kelley, supra note 16 (discussing partnership analogy and close corporation needs as related to the team specific investment).

53 For a definition of oppression (infra. III.). Exploitation refers to the fact that directors are not accountable to shareholders and thus they can exploit the investment of the shareholders in other ways than in shareholders best interest (supra. I.B.I.a.).

54 Easterbrook, Agency cost, supra note 5 at 273

55 Id. at 272
the minority shareholder does not receive any return on his investment. He is excluded from participation in earnings and unable to withdraw.\textsuperscript{56}

Corporate law does not give the majority absolute discretion. But, because the adaptability mechanism of corporations is the board of directors governed by majority rule, the corporate structure favors the majority\textsuperscript{57}. It is this bias that close corporation statutes should eliminate and thus make oppression, if not "unique", at least unlikely.

2. The partnership analogy

The close relationships between the members of close corporations is the same as between partners in a partnership. Since most characteristics of close corporations and partnerships are identical the idea of using partnership rules in the close corporations context arose rapidly\textsuperscript{58}. Is it not that close corporations are in fact "incorporated partnerships"?

Already in 1948 Israels noted the identity between close corporation and partnerships\textsuperscript{59}. The partnership analogy has further been fully developed by John Hetherington and Michael Dooley as a way to protect minority shareholders from the majority gap-filling authority\textsuperscript{60}. There are good grounds for applying partnership law to close corporations. Both entities are characterized by the same kind of close relationships. This becomes obvious when compared to public corporations\textsuperscript{61}. Investors in close

\begin{flushleft}
\textsuperscript{56} Hetherington Needs of close corporations, supra note 21 at 21
\textsuperscript{57} O'Kelley supra note 16 at 240
\textsuperscript{58} Note that until the end of the 19th century most businesses where organized as partnerships. Incorporation was a privilege. Charles B. Blackmar, Partnership Precedents in a Corporate setting -- Exit from the Close Corporation, 7 J. Corp. L. 237, 238-239 (1982)
\textsuperscript{59} Israels, Close corporations, supra note 6 at 488, 491 (Participants in close corporation desire to combine the limited liability of corporation and the decentralized governance of partnerships)
\textsuperscript{60} O'Kelley supra note 16 at 217
\textsuperscript{61} MELVIN A. EISENBERG, THE STRUCTURE OF THE CORPORATION, 9-11, (1976) (comparing the decision-making process and the common characteristics of partnerships and close corporations)
\end{flushleft}
corporations or partnerships have approximately equal access to information, for them it is more efficient to take decision by consensus, both entities are founded by individuals with strong feeling of trust. Because the close corporations actors treat each other like partners, the automatic buy out rights, the strict fiduciary duties and equal sharing rules of partnership law should also be the fundamental principles of corporate law.\(^{62}\)

The view that partnership law is not adapted to corporate needs has also prestigious proponents. First, they argue, that the analogy is based on a misstatement of partnership law. The dissolution of partnerships induces liabilities neglected by the analogy. Moreover, the buy out price in partnership does not include future earnings as do equities. Second, the gaps in the close corporations contract should be filled with what “parties would have bargained for.” In many cases the corporation form was chosen for all its characteristics, certainly by the majority shareholders, and not only for the limited liability or the perceived tax advantage.\(^ {63}\) This choice should be respected whatever the resemblances between partnerships and close corporations.

The partnership analogy, however, remains a useful tool for analyzing the close corporate context. A more detailed discussion of the analogy will follow when we address fiduciary duties in close corporations or tackle the problem of dissolution and buy out. (Infra IV. for discussion of fiduciary duty and V. for discussion of dissolution). To the extent court increasingly accept individual cause of actions based on breach of fiduciary duty and broaden the grounds of involuntary dissolution the close corporation law moves closer to partnership law.

\(^{62}\) Hetherington, *Illiquidity*, supra note 29 at 2-3

\(^{63}\) See EASTERBROOK'S, CORPORATE LAW, supra note 5 at 249-250
C. Legislative recognition of the close corporations peculiarities

Legal literature has been the only source of pressure for legal reform in the close corporate context. The reasons are diverse. Unlike major corporations who lobby to effect changes in corporate law close corporations are not represented by any organization. The experience of close corporate actors is isolated and unique, the information not available and confidential. Hence, the problems defined in the literature are those addressed by the legislator\(^64\).

After World War II and especially since the sixties, state legislation was adopted to accommodate the special needs of close corporations\(^65\). In 1982 the " Model Statutory Close Corporation Supplement" was adopted by the American Bar Association\(^66\). The adoption boosted the recognition of the need for special close corporation legislation\(^67\). Some state legislators used the same "integrated" approach as the "supplement" whereby the articles concerning close corporations are brought together in a comprehensive supplement to the general corporations law\(^68\). Others adopted various provisions for close corporations scattered throughout the general corporate law\(^69\). Most integrated codes are modeled on the Delaware provisions\(^70\). Six states followed the "supplement" pattern\(^71\). A

\(^{64}\) Hetherington Needs of close corporations, supra note 21 at 1-4

\(^{65}\) O’Neal, Close Corporations: Existing Legislation and Recommended Reform, 33 Bus. Law. 873 (1978)

\(^{66}\) For a critical analysis of “the supplement” see Richard A. Mann., A critical analysis of the statutory close corporation supplement to the model business corporation act, 22 Am. Bus. L. J. 289, 336 (1983); Rodman Elfin, A critique of the proposed statutory close corporation supplement to the model business corporation act, 8 J. Corp L. 439, 454 (1983)


\(^{69}\) Most states in fact have not chosen for the integrated approach e.g. Michigan, New York (See list at note 68 of those who have an integrated approach); Forrest B. Weinberg, The close corporation under Ohio law, 35 Clev. St. L. Rev. 165, 172 (1986)

third group of states has opted for a different kind of provisions, mainly Arizona and Maryland. None of the close corporation legislation is self-contained, exclusive law. General corporations law remains applicable and is only supplemented by close corporations legislation.

The statutes of California, Delaware, Florida, Maine, Maryland, New York, North and South Carolina are considered to be especially accommodating for close corporations.

The different statute have handled the definition of close corporation in various ways. The "supplement" for instance, defines and is thus applicable to close corporations who have elected for close corporate statute by including a statement in the articles of incorporation. Are eligible, corporations having fewer than 50 shareholders at the moment of election and where two-thirds of the holders of the votes approve the amendment of the articles. The definition does not provide for a maximum limit of shareholders after the election of close corporate statute. The aim is to avoid the

\[\text{supra} \text{ note 2 at } \S 1.18 \text{ (ads to the states modeled on the Delaware provisions: Alabama and Nevada. But he does not consider Illinois Philadelphia and Texas. Those three are classified in the more peculiar third category with Arizona and Maryland)}\]

\[71\text{ O'NEAL'S, CLOSE CORPORATIONS, supra note 2 at } \S 1.18 \text{ (Georgia, Missouri, Montana, South Carolina, Wyoming and Wisconsin. Naturally they are not totally identical e.g Georgia has opted for a 50 shareholders limitation for electing, while South Carolina has not)}\]

\[72\text{ Model Stat. Close Corp. Supp. } \S 55 \text{ (special comment- statutory comparison)}\]

\[73\text{ Forrest B. Weinberg, The close corporation under Ohio law, 35 Clev. St. L. Rev. 165, 172 (1986)}\]

\[74\text{ HENN, supra note 19 at 178 (note that the Florida statute was repealed in 1975, that for instance North Carolina and New York have no special provisions for close corporations)}\]

\[75\text{ Model Stat. Close Corp. Supp. } \S 3(a); \text{ other states with elective statutes are for instance Delaware, Kansas, Maryland, Texas. Not all codes require from a corporation to elect close corporation statute)}\]

\[76\text{ Model Stat. Close Corp. Supp. } \S 3(b); \text{ E.g. 805 Ill. Comp. Stat. 5/2A.10 (in Illinois a corporation can elect for close corporate statute but their is no ceiling); Mich. Comp. Laws Ann. } \S 450.1201, 1202 \text{ (e.g. One of the purpose of the Michigan statute is to meet the needs of close corporations. However it does not recognize close corporations as a separate corporate legal form. Therefore there is no requirements for close corporations statue disclosure in the articles of incorporation or a defined maximum amount of shareholders)}\]

\[77\text{ After election a corporation can have more than 50 shareholders. For other statutes with numerical limitations see supra note 8}\]
automatic termination of close corporations statute above some arbitrary maximum. Even a public share offering does not cause lose of statute\(^78\). Is it reasonable to allow corporations who do not have any more the characteristics or the needs of close corporations to be still governed by close corporations statutes? The argument that the 50 shareholders limit at the time of election is there to prevent larger corporations of electing for close corporations statute\(^79\) supports the view that a ceiling is necessary. Even if it must be admitted that the risk that some larger corporations will abuse the "supplement" to avoid some obligations is limited. There is no evidence of any abuse until now\(^80\). This is maybe the reason why no ceiling is provided for new close corporations\(^81\).

Another flaw in the definition of the "supplement" is that election of close corporate statute is made for all purposes. Special tailored close corporations provision like the judicial dissolution do not apply if no election is made. This is in contradiction with the remedial approach of the law\(^82\).

The issues addressed in the close corporation legislation are, besides the definition of close corporations, share transfer restrictions, possible shareholders agreements, other means of modifying the centralized control of the board of directors, broad judicial reliefs

\(^78\) O’NEAL’S, CLOSE CORPORATIONS, supra note 2 at § 1.02 n.8 (citing Professor Ernest L. Folk’s report to the Delaware Close Corporations Committee pointing out that if the definition excludes corporations who at one moment in time have regularly traded shares, the lost of statute maybe caused by an event out of control of the corporation at an not appropriate moment)

\(^79\) Model Stat. Close Corp. Supp. §3 (comment)

\(^80\) Model Stat. Close Corp. Supp. §3 (comment); O’NEAL’S, CLOSE CORPORATIONS, supra note 2 at § 1.02; Bradley. An analysis of the model close corporation act and a proposed legislative strategy, 10 J. Corp. L. 817, 820 (1985) (It is unlikely that larger corporation will elect for close corporation statute. The requirement that all shareholders must consent to a shareholder’s agreement refrains this risk See Model Stat. Close Corp. Supp. § 20 (a))

\(^81\) The text of the statutes clearly sets a shareholders limit for corporations amending their articles. But a new corporation does not amend its articles: Some close corporations statutes have limited the amount of allowed shareholders e.g Del. Code. Ann. tit 8 § 342(a)(1) (in Delaware a close corporation risks losing statute if its shares are held subsequently by more than 30 shareholders)

\(^82\) Bradley, supra note 80 at 820
for shareholders dissension and rules regarding informality. The available reliefs are often divided in three categories: a list of ordinary reliefs including provisional directors and custodians and two extraordinary reliefs, share purchase and dissolution.

Flexibility and a-formalism characterizes the new close corporations legislation. In many statutes the board of directors or the annual shareholders meeting can be eliminated. The "supplement" provides for share transfer restrictions and right of first refusal unless stated otherwise in the articles of incorporations. Some state like California and Delaware provide sanctions when the transfer restrictions are not respected. Finally, the "supplement" validates unanimous written shareholder agreements. Most states allow substantial contractual freedom.

Statutes with the flexibility of the Revised Model Business Corporation Act (hereafter RMBCA) make it possible to achieve desired legal results by the use of sophisticated contractual shareholders agreements. The "supplement" therefore does not

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83 O’NEAL’S, CLOSE CORPORATIONS, supra note 2 at § 1.18; HENN, supra note 19 at 699 n.2 , 701; See generally for a comparative study of close corporations legislation, Siedel, supra note 19. And for a study of model act, Bradley, supra note 80 at 820 or Robert A. Kessler, The ABA close corporation statute, 36 Mercer L. Rev. 661 (1985)

84 Model Stat. Close Corp. Supp. §3 (comment 4). The "supplement" adopted a compromise by requiring a 2/3 vote of each class of series of shares, voting as separate voting groups. The Delaware statute for instance, followed by most states, requires a 2/3 vote of all outstanding shares. Maryland and Texas require unanimous consent

85 EASTERBROOK’S, CORPORATE LAW, supra note 5 at 234 (Note an evolution of close corporations statute towards enabling laws allowing considerable flexibility in structuring the firm and contractual agreements); EISENBERG, supra note 61 at 9 ( even Professor Eisenberg opponent of contractual model of public corporations, believes in close corporations participants should be allowed to adopt governance structure they pleased)

86 E.g. Md. Code Ann., Corps. & Ass’ns § 4-302

87 E.g. Model Stat. Close Corp. Supp. § 23(b), Del, Code. Ann. tit. 8 § 351 (all corporate powers can be given to shareholders)

88 O’NEAL’S, CLOSE CORPORATIONS, supra note 2 at § 1.14

89 Model Stat. Close Corp. Supp. § 20; See also Model Bus. Corp. Act § 7.32 as amended in 1991 (validating all kind of shareholders agreements without requiring an election of close corporations statute); See Thompson, Shareholder’s Cause, supra note 24 at 704 (Most states expanded the ability of parties in close corporations to contract around the majority rule and centralized control to protect jobs and salaries); O’Kelley, supra note 16 at 242-245 (for a general discussion of the need of contractual modifications in the different types of close corporations)
significantly changes the results obtainable under the RMBCA. However it provides certainty, flexibility and lowers the transaction cost since less drafting is required. As a matter of fact only a few corporation elect for close corporations statute. The lack of acquaintance with the "supplement" explains only partially this disinterest since the "supplement" is not disadvantageous to close corporations. In fact in a minority shareholders oppression case it is of little importance whether a close corporations is also a statutory close corporations.

D. Changes in judicial attitudes

Not only the legislators but also the court have learned to recognize the specific needs of close corporations. Courts are increasingly willing to recognize shareholders agreement modifying traditional corporate norms. This was not the case in the early

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90 Model Stat. Close Corp. Supp. (introductory comment); Easterbrook, Agency cost, supra note 5 at 283 (Corporate law is a set of standard terms that lowers the costs of contracting. Importance of statutes has been exaggerated. They track the terms people have been negotiating for years)

91 O’NEAL’S, CLOSE CORPORATIONS, supra note 2 at § 1.19

92 Justis, supra note 15 at 265-266 (the only difference between a corporation who elected close corporation statute. Is that under RMBCA minority shareholders in statutory close corporations must show that they have exhausted all forms of non judicial remedies before they can file a lawsuit for oppression); Berger supra note 5 at 703-708 (A thorough discussion of the advantages and disadvantages of electing close corporate statute, especially in California. He cites as advantages: 1) Some optional provisions can be drafted in shareholder agreement and do not need to be in the charter 2) ability to bargain for partnership rules 3) flexibility on voting and shareholders agreement. As disadvantages 1) higher risk of lock-in because of share transfer restriction 2) Petition for involuntary dissolution can be filed by any shareholder while in non statutory close corporation the shareholder must own a substantial amount of shares, Cal. Corp. Code § 1800 (a)(2). This provision results in a high harassment potential. (The second disadvantage of Berger is debatable. See infra. V. the discussion on dissolution))

93 See Generally, Thompson, Shareholder’s Cause, supra note 24 at 699 (for a discussion of the general trends); O’NEAL’S, CLOSE CORPORATIONS, supra note 2 at §1. 20

94 Easterbrook, Agency cost, supra note 5 at 279-283
years of *McQuade v. Stoneham*\textsuperscript{95}. But nowadays shareholders agreement are controlled by *Clarek v. Dodge*\textsuperscript{96} and *Galler v. Galler*\textsuperscript{97}. The liberal contractual attitude of courts is supported by most new statutes\textsuperscript{98}. Furthermore, influenced by the partnership analogy, courts, invoke a heightened standard of fiduciary duty for close corporations. The majority shareholders owe the minority "utmost good faith and loyalty"\textsuperscript{99} (infra IV. for a discussion of fiduciary duties). But the most impressive change over the last decennia has been on the remedies issue. While courts originally viewed dissolution as drastic and granted the remedy sparingly their seems now to be greater readiness to do so\textsuperscript{100}.

Alongside the dissolution remedy a wide variety of equitable solution have been developed. For instance an order to compel dividend, appointment of custodians or provisional directors, imposed buy outs, repeal of boards decisions. The role of courts is increasingly important in that area since statutes give them broad discretion in choosing the appropriate remedies\textsuperscript{101}.

Courts activism has two drawbacks. Courts gap-filling decisions create a disincentive for parties to draft a contract wherein they set out the balance they wish to achieve between opportunism (=partnership rules) and (collective) adaptability (=majority

\textsuperscript{95}263 N.Y. 323, 189 N.E. 234 (1934). (Where the court invalidated an agreement between shareholders to use the best effort to vote for each other as directors and officers. By deciding so the court allowed Stoneham to welch on the guarantees that induced McQuade to invest in the corporation. "A contract is illegal and void so far as it precludes the board of directors, at the risk of incurring legal liability, from changing officers, salaries, or policies retaining individuals in office, except by consent of the parties")

\textsuperscript{96}269 N.Y. 410, 199 N.E. 641 (1936) (allowed a minority shareholders to enforce an agreement granting him the right to stay in office and receive one forth of net income as salary or dividend so long as he was "faithful, efficient and competent); See also Benintendi v. Kenton Hotel, Inc., 294 N.Y. 112, 60 N.E. 2d 829 (1945) (reaffirming the majority rule.)

\textsuperscript{97}32 Ill.2d 16, 203 N.E.2d 577 (1964). (Broadly interpreted this case validates all agreements in close corporations absent prejudice to third parties (and not in direct contravention of a statute). An agreement providing for salary and dividend payment was upheld.). See also Zion v. Kurtz, 50 NY2d 92, 428 NYS2d 199 (1980) (liberal towards allowed shareholders agreements not respecting formalities imposed by statute but conform with statute)

\textsuperscript{98}Supra, note 89

\textsuperscript{99}Donahue v. Rodd Electrotype Co., 367 Mass. 578 at 593

\textsuperscript{100}Easterbrook, *Agency cost*, supra note 5 at 286

\textsuperscript{101}O'NEAL'S, CLOSE CORPORATIONS, supra note 2 at §1.20
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\textsuperscript{100}Easterbrook, Agency cost, supra note 5 at 286

\textsuperscript{101}O’NEAL’S, CLOSE CORPORATIONS, supra note 2 at §1.20
rule). Furthermore every time courts err by applying partnership rules to corporations where the rational investors "would not have wanted" those rules, courts devaluate the close corporate form\textsuperscript{102}.

However, the total picture of courts decisions is positive. Courts flexibility, enforcing various shareholders agreements, scrutiny applying higher standards of fiduciary duty and increased readiness to dissolve corporations or tailor adapted remedies has created a healthier environment in which minority shareholders fear less to be deprived of any return on investment. But, the more legislatures and courts allow participants in close corporations to structure their relations by agreement and to contract for partnership veto powers, the more deadlock and stalemate cases will arise\textsuperscript{103}.

\textsuperscript{102} O'Kelley, \textit{supra} note 16 at 247

\textsuperscript{103} Israels, \textit{Sacred cow, supra} note 18 at 781
Chapter III. Oppression

A. In concreto

The participant in the close corporation venture might decide one day to eliminate or at least reduce the influence of one or more co-venturers. The underlying reasons can be diverse, going from greediness to perfectly rational business decisions based on the performance and behavior of the co-venturer. O’Neal’s oppression treatise list many of those grounds e.g.: greed, desire for power, family quarrels, conflict of interest, disagreement over policy, inactive shareholder, death of key shareholder, drive of superior talent, aged founder who "hangs on" and so on\(^\text{104}\).

In doing so, shareholders can use a wide variety of techniques which can be categorized in two groups. Those leading to a cash-out of the unwanted shareholders and those where while the shareholders loses every influence and return on investments, he is not bought out. The second situation where a shareholder although “squeezed-out” or “frozen-out” stays “locked-in” is common to close corporations\(^\text{105}\). In a public corporation, though maybe unwilling, the shareholder can always sell his shares. He is never "locked-in".

\(^{104}\) F. HODGE O’NEAL & ROBERT B. THOMPSON, O’NEAL’S OPPRESSION OF MINORITY SHAREHOLDERS §2 (2d ed. 1985) [hereinafter O’NEAL’S, OPPRESSION] (O’Neal is not only the grandfather of the close corporations legislation but also a leading authority in minority oppression)

\(^{105}\) O’NEAL’S, CLOSE CORPORATIONS, supra note 2 at §8.13
Cash out techniques are usually related to mergers or share exchange. Like for instance: reverse stock-split, buy out of already excluded minority while withholding information about share value, merger consolidation, compulsory share exchange\textsuperscript{106}. Non cash-out squeeze-out techniques are: withholding dividends, elimination from the board of directors and from company’s employment, high compensation to majority and other techniques of siphoning earnings, denial of access to books and records and other sources of information, misappropriation of corporate assets for personal use or by a company controlled by the majority and so on\textsuperscript{107}.

To most of this squeeze out techniques, their are appropriate remedies. Unfair mergers can be challenged with the rules governing mergers, the right of access to corporate books and records is explicitly provided in the corporate law, misappropriation of corporate opportunities and assets can also be challenged. However all those legal battles the minority is fighting, even when won, are just another pyrrhic victory. The majority stays in control, the minority remains locked-in, and the game off oppression continues. At one point in time it is necessary to allow the minority to withdraw it’s investment under fair conditions. A close corporation can not work when parties are not willing any more to cooperate. It is here that the dissolution and buy out remedy pop-in, as last resort and definitive remedy for oppression.

\textsuperscript{106} O’NEAL’S OPPRESSION, supra note 104 at §3:02; O’NEAL’S CLOSE CORPORATIONS, supra note 2 at § 8.13

\textsuperscript{107} O’NEAL’S OPPRESSION, supra note 104 at §3:02; See also Note. Freezing Out Minority Shareholders, 74 Harv. L. Rev. 1639 (1961) (describing those techniques one by one)
B. General principles of corporate law

It has already been stated that some scholars contend that minority shareholders in close corporations face "unique" risks of oppression. This is so because the general principles of corporate law ignore the peculiarity of close corporations. The majority rule and the business judgment rule are the two principles making the use of the wide range of oppression techniques described above legal and difficult to challenge.

1. Shareholder Democracy, Majority Rule and Centralized Control.

Those possessing the majority of the shares elect the board of directors. Normally the whole board or at least the majority of the board if their is a cumulative voting provision. The board of directors is invested with "all corporate powers". "(That) shall be exercised by or under the authority of, and the business and affairs of the corporation managed under the direction of, its board of directors, subject to any limitations set forth in the articles of incorporation or in an agreement authorized under section 7.32\textsuperscript{108}". Normally, a majority vote is sufficient to have a decision taken by the board. The scheme is clear. Unless the minority has bargained for some protection and restrictions of the power of the majority, they will not be heard\textsuperscript{109}. Those with the majority control the corporation. This is not an anomaly, since they invested more than others, they bear higher risks and thus should be able to control this risks. Lets not forget however, that in close corporations there are no market forces present to counter the centralized control\textsuperscript{110}.

\textsuperscript{108} Model Bus. Corp. Act § 8.01(b)

\textsuperscript{109} O'NEAL'S, OPPRESSION, supra note 104 at §1:03

\textsuperscript{110} O'NEAL'S, CLOSE CORPORATIONS, supra note 2 at §1.15
2. The Business Judgment Rule

The business judgment rule is an evidentiary presumption that directors act in accordance with their duty of care\textsuperscript{111}. The business judgment rule requires judicial deference to corporate decisions. The judge-made rule guarantees non-interference by the courts and thus immunizes partially management from liability\textsuperscript{112}.

Limitations to the protection afforded by the business judgment rule have been set out in \textit{Aronson v. Lewis}\textsuperscript{113}: only disinterested directors, who make informed decisions, are protected. The protection has even been more limited by courts in cases concerning special litigation committee’s of public corporations deciding on the opportunity of derivative suits\textsuperscript{114}. With the exception of those cases, courts expect proof of “gross negligence” to challenge a business decision\textsuperscript{115}. Only then, when the rule has been rebutted, will courts scrutinize the decision to its intrinsic fairness to the corporation and the corporation’s minority shareholders\textsuperscript{116}. Fraud, lack of reasonable care and self dealing are not protected\textsuperscript{117}.

The rule is justified by the belief that it reassures capable managers, encourages risk taking and deters risk of abuse of derivative litigation. Although, reassuring the managers in close corporations is not needed as much as in public corporations. The threat of litigation by shareholders is not so serious in close corporations since the shareholders are

\begin{footnotes}
\item[111] Smith v. Van Gorkem, 488 A.2d 858, 872 (Del. 1985)(If the board takes an informed decision, the decision is protected. The duty of care is a process duty not a qualitative duty)
\item[112] HENN, supra note 19 at 661-663
\item[113] 473 A.2d 805, 812 (Del. 1984)
\item[115] Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984)
\end{footnotes}
often the managers of the company. Hence, risk taking in close corporation is not only
based on sound business judgment but often on non-business motivations. The business
judgment rule can not cover the complex web of relationships existing in close
corporations.118

The classical argument supportive of the business judgment rule states that it is not
the function of the judge to review business judgment. He lacks expertise. How true this
may be, at some point, the judge has to interfere. Why not accept that in the close
corporations the room to maneuver of the majority is narrower? Less than the traditional
bad faith requirement should be required to trigger an intervention of the judge.119 Judges
already have accepted to replace their own business judgment in control over derivative
litigation issues.120 Moreover, courts often second guess other types of professionals like
psychiatrists and architects.121

The basic problem is that the business judgment rule is based on assumptions that
are not present in close corporations. Directors who are at the same time shareholders and
employee, lack independence. The external factors of control that regulate management
conduct and (ab)use of the business judgment rule like the securities market and the
securities market regulations do not play a role in close corporations.122 The business
judgment rule is in fact a mechanism enhancing shareholder passivity, only useful in
public corporation where the active role must be confined to the managers. This for
obvious practical reasons.123

118 Ralph A. Peeples, The Use and Misuse of the Business Judgment Rule in the Close Corporation, 60
Notre Dame L. Rev. 456, 483-484 (1985) (See also generally, this article for a complete discussion of the
role of the business judgment rule in close corporations)
119 Peeples supra note 118 at 484-485
120 See supra note 114 and accompanying text
121 O'Neill supra note 17 at 682
122 Id. at 681; Peeples supra note 118 at 485-486; Justis, supra note 15 at 272-273
123 O'Neill supra note 17 at 679-682
Few have questioned the application of the business judgment rule in the close corporation context. However, a too strict application in this context has dramatic results since all decisions concerning dividend policy, employment and compensation, stock issuance and dissolution either originate in the board or directors or are ultimately decided there.

An example on the dividend policy issue shows this. Courts in *Gottfried v. Gottfried* and *Ziddel v. Ziddel* refused to review dividend policies if the bad faith of the board was not proven. The bad faith requirement is the result of the business judgment rule presumptive protection. Thus, usually the business judgment rule applied in the close corporate context is not able to take personal and other specific considerations typical of close corporations into account. However the business judgment rule is not unlimited. In *Dodge v Ford Motor Co*, the court stated that bad faith can be found if the company builds up an unreasonably large cash reserve. A statement helpful to have dividend policies reviewed in close corporations.

Other criteria of evaluating business decisions do not prove to be more satisfactory than the business judgment rule. The intrinsic fairness test, for instance, shifts the burden of proof to the directors. But the question remains to whom the decision must be fair: to the corporation, to the majority or to the minority? (Infra. IV for a discussion of the duty of the majority towards the minority).

The better approach may be to narrow down the protection afforded by the business judgment rule in close corporations. Keeping in mind that the rule remains useful in many

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124 Peeples *supra* note 118 at 467; O’NEAL’S, OPPRESSION, *supra* note 104 at §3 9.04

125 Peeples *supra* note 118 at 468-469

126 73 N.Y.S.2d 692, 695 (Sup. Court. 1947)

127 277 Or. 413, 560 P.2d 1086 (1977)

128 Peeples *supra* note 118 at 472

129 *Dodge v. Ford Motor Co.* 204 Mich 459, 509 (1919)

130 Peeples *supra* note 118 at 492-494 (to the extent one knows what “fair” means)
situations where business decisions are made that do not affect minority shareholders expectations. Protection of business judgment is essential for a corporation to be managed efficiently, profitably and to allow risk taking by the majority. A flexible interpretation of the rule in close corporations will guarantee protection for "non oppressive" business decision and at the same time permit courts intervention so as to protect minorities. A step in the good direction, but certainly not satisfactory, is the less harmful means doctrine that permits a showing by the minority that a protected business decision could be executed in a less harmful way.

C. Legislative definition of “oppression techniques”

“Oppression” is the generic legal term that encompasses all the “oppression techniques” described above. While most oppressive techniques can be challenged individually without need for a generic term, some cannot. Moreover, as we concluded above, it makes little sense to fight each oppressive conduct on a separate legal ground. This approach does not offer a real, permanent solution. This is why many statutes began to include oppression or similar language as a general ground for relief.

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131 O’Neill supra note 17 at 683 (giving an example with a corporation purchasing raw material from one purchaser rather than another. In this case "it is legitimate to conclude that all parties had agreed, at the outset, to be bound by the majority’s vote") (See infra. III. E. 2, reasonable expectations preempts business judgment rule)

132 Murdock, supra note 31 at 429

133 Wilkes v. Springside Nursing Home, Inc., 370 Mass. 842, 848-849, 353 N.E. 2d 657, 661 (1976) (this case is. a major case for close corporations and will be discussed thoroughly); Peeples supra note 118 at 499-500; Justis, supra note 15 at 273-274 (discussing which courts applied the "legitimate business purpose" test (= less harmful means) in close corporations e.g. Georgia yes, Missouri no)

134 See supra III. A.

135 In New York for instance only for close corporations, N.Y. Bus. Corp. Law § 1104-a, in the MBCA for instance for all corporations, Model Bus. Corp. Act § 14.30
Oppression as a basis for relief is noteworthy because it breaks the myth that only a harm to the corporation can be compensated. The term oppression is a recognition in itself of the rights of the minority by the legislatures\textsuperscript{136}. It is useless to consider "oppression" isolated. It is in fact intimately linked to the reliefs it makes available, especially to dissolution and buy-out\textsuperscript{137}. Nowadays most statute list "oppression" as a ground for dissolution. A discussion of the advantages and disadvantages of oppression and the reasonable expectations doctrine includes a discussion of the advantages of dissolution and vice versa. Many arguments in this discussion are, if not the same, closely related to each other (Infra V. Judicial dissolution).

Oppression as a ground for relief was first included in Illinois and Pennsylvania in 1933, in the MBCA in 1946 and in the English Company Act of 1948\textsuperscript{138}. The MBCA grants judicial dissolution for "illegal, oppressive or fraudulent" conduct\textsuperscript{139}. Most states, like the MBCA, also grant dissolution for waste and fraud\textsuperscript{140}. Thirty-one states included oppression in their statutes and six have similar language\textsuperscript{141}. Four states use the words "unfairly prejudicial" instead of "oppressive"\textsuperscript{142}. Both terms are considered to be closely related. Because of the link with the dissolution remedy the statutes were not widely used in the beginning. This was caused by the traditional unwillingness of courts to dissolve a


\textsuperscript{137} Thompson, Shareholder's Cause, supra note 24 at 718 ("Consideration of the broadened use of the oppression action is incomplete without also focussing on the remedy provided if oppression is found")

\textsuperscript{138} Id. at 709 (citing, 1933 Ill. Laws 308, 351; MBCA § 90, reprinted in 6 Bus. Law. 1, 75-76 (1950); Companies Act 1948 § 210)

\textsuperscript{139} Model Bus. Corp. Act § 14.30

\textsuperscript{140} Examples; Harry J. Haynsworth, The effectiveness of involuntary dissolution suits as a remedy for close corporation dissension, 35:1 Clev. St. L. Rev. 25, 35-36 (1987) (Noting courts have place fraud, illegality, waste or misapplication of corporate assets in one category and that in a second category they have placed oppression, unfairly prejudicial and persistent unfairness)

\textsuperscript{141} Thompson, Shareholder's Cause, supra note 24 at 709 n. 70 (for a list of those states)

\textsuperscript{142} Id. (those are Alaska, California (see also infra note 150 and accompanying text, the second very broad ground that California has), Minnesota and North Dakota)
going concern enterprise. On the other hand it can be stated that the inclusion of “oppression” in statutes has opened “a much broader avenue of relief” for minorities.

While many statutes have adopted the “oppressive terminology” most have declined to define the term. The official comment to the “supplement” expressly indicates that no attempt is made to statutorily define oppression, so as to leave these “elastic terms” to a case by case judicial interpretation. Minnesota and North Dakota have expressly adopted the reasonable expectations standard to interpret “oppression” in their legislation. In a 1994 amendment, Minnesota’s “reasonable expectations” language was changed to “reasonable expectations of all shareholders”. In the buy out provision the legislature added a presumption that written shareholders agreement reflect the reasonable expectations for the matter addressed in the agreement.

A substantially different terminology is found in North Carolina and California. Their statutes provide minority relief when "reasonably necessary to protect the rights and interests" of the shareholder. However, the judiciary of both adopted the reasonable expectation standard to define the “rights and interests of shareholders”. The terminology focusses the attention of the court on the rights of the minority and seems to be broader than “oppression”. Maryland has also a very broad (close corporation) statute: “there is such internal dissension among the stockholders of the corporations that the

143 Thompson, Shareholder’s Cause, supra note 24 at 709
144 Arthur D. Spratlin, Jr. Comment, Modern Remedies for oppression in the closely held corporation, 60 Miss. L. J. 405, 409 (1990) (quoting, O’NEAL’S, CLOSE CORPORATIONS, supra note 2 at §9.29)
145 Model Stat. Close Corp. Supp. § 40 (official comment 2.)
147 Id. (Previously courts refused to follow the plain language of shareholders or employment agreements)
149 Cal. Corp. Code § 1800 (b)(5) (remember that California also has the “unfairly prejudicial” terminology); See also Alaska stat. § 10.06.628(b)(5)
business and affairs of the corporation can no longer be conducted to the advantage of the stockholders generally."\textsuperscript{151} Connecticut provides dissolution for "fraud, collusion or gross mismanagement" or for "any good and sufficient reason."\textsuperscript{152} Thompson classifies the remaining states in three groups those states that list "illegality or fraud", those that only list "deadlock" and finally those states that have no statutory ground for a shareholder to seek dissolution\textsuperscript{153}.

"Oppression" or other triggering terms like "unfairly prejudicial" can also be limited towards the persons to whom they apply. Most statutes do not list exhaustively in what capacity a shareholder must be oppressed but only provide a general "right of a shareholder to request dissolution."\textsuperscript{154} Nevertheless "oppression" is generally viewed as including oppression towards "shareholders in their capacities as directors, officers or employees". In that way a decision is avoided stating that the shareholders can only act in their capacity as shareholder while in most close corporations cases relief is needed in the capacity of employee or officer\textsuperscript{155}.

We conclude that it is necessary to have a generic term for a scheme of oppression techniques to trigger relief. Which is the better term: "oppression", "unfairly prejudicial", "the corporation can no longer be conducted to the advantage of the stockholders generally" or "reasonably necessary to protect the rights and interests of shareholders"? To the contrary of what one might think it does not matter that much. What matters is the standard that will be used to interpret and define oppression. But if a choice must be

\textsuperscript{151} Md Code Ann., Corps & Ass'ns § 4-602 (1996)
\textsuperscript{152} Conn. Gen. Stat. § 33-382
\textsuperscript{153} Thompson, Shareholder's Cause, supra note 24 at 709 n. 70 (The first group: Hawaii, Kentucky, Maine, Nevada, Florida (misapplication of assets or waste). The second group: Arizona, Washington D.C., Indiana, Massachusetts, Ohio, Louisiana. The third group: Delaware (but a special agreement is possible for close corporations) Kansas and Oklahoma)
\textsuperscript{154} But See Minn. Stat. Ann. § 302A.751 (as shareholder, director, officer or employee); S.C. Code Ann. § 33-14-300 (as shareholder, director or officer)
\textsuperscript{155} Thompson, Shareholder's Cause, supra note 24 at 714 (alluding to the restrictive interpretation in English company law)
made “oppression” seems the most appropriate. Its “common sense” meaning depicts well the situation which the legislator has in mind. While the other terms are or to vague (“interest of shareholders”) or refer unnecessarily to “fairness” a concept closely related to fault.

D. Judicial definition of “oppression”: evolution from a fault based standard to reasonable expectations

The evolution of the interpretation of “oppression” evolves in parallel with the understanding and acceptance by the judiciary and the legislatures of the special characteristics of close corporations. This growing awareness allowed a permanent broadening of the interpretation of oppression. Judicially, the term has also eluded a clear definition. The descriptions of “oppression” are dependent of the specific factual setting of the case. The undefinedness and factualness of “oppression” has not prevent a search for a “standard” of oppression.

The very first decisions interpreting oppression were very restrictive because of the link with dissolution and the fear of abuse by the minority. Oppression allowing dissolution was only found in “extraordinary circumstances” or “if corporate ruin will inevitably follow” and thus “in the context of corporation’s overall financial picture.”

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156 Id. at 711
157 Peeples supra note 118 at 488
158 Thompson, Shareholder’s Cause, supra note 24 at 709-711
The second wave of decisions used a fault based approach. Oppression as a departure from the notions of fair play and fair dealing defined as “burdensome, harsh and wrongful conduct”. Fiduciary duties was seen as a concept adapted to close corporations. Thus some courts explicitly made the link to an action for breach of fiduciary duty. While in Central Standard Life Insurance Co. v. Davis "oppression" was recognized as a separate cause of action distinct from fraud (and illegality) in White v. Perkins and Baker v. Commercial Body Builders the courts used the fiduciary duty of good faith and fair dealing (fair play) to find oppression. This fault based approach has first been developed in English company law.

Not surprisingly, it appeared to be very difficult to define standards of fair dealing and fair play. Moreover, those standard could not cover typical oppression situations in close corporations. For instance where the majority acting without fault "squeezes" the minority out of the corporation.

The parallel development of alternatives to dissolution freed the courts to broaden the scope of oppressive conduct and allowed them to adopt the reasonable expectations standard. The standards departs from the bargain struck by parties and does not require any fault. The idea beyond the reasonable expectation doctrine is to find the hypothetical

162 Sandra K. Miller, Should the definition of oppressive conduct by majority shareholders exclude a consideration of ethical conduct and business purpose?, 97 Dick. L. Rev. 227, 236 (1993)
163 Skiera v. Skiera Bros., Inc. 629 P.2d 214, 221 (Mont. 1981)
164 Some courts went further and adapted fiduciary duties to close corporations by using a strict standard of "utmost good faith and loyalty" for a discussion of this approach see infra. IV
165 141 N.E.2d 45, 49 (Ill. 1957)
166 189 S.E. 2d 315 (Va. 1972)
167 507 P.2d 387 (Or. 1973); See also recently, Giannoti v. Hamway 387 S.E.2d 725, 730 (Va. 1990) (fair dealing standard)
168 Peeples supra note 118 at 501 ("the parties", reasonable expectations could be described as an implied multilateral contract among the shareholders); Topper v. Park Sheraton Pharmacy 433 N.Y.S. 2d 359, 365 (N.Y.Sup. Court. 1980) ("these reasonable expectations constitute the bargain of the parties in light of which subsequent conduct must be appraised")
169 Murdock, supra note 31 at 458, 46; The gradual general acceptance of dissolution as a valid remedy played naturally the same role
bargain between the parties such as to allow courts to fill in the gaps of the contract. Broadly interpreted there is "oppression" when reasonable expectations are frustrated.

A growing number of jurisdiction have adopted the reasonable expectations standard to define oppression, are among those: Alaska, Iowa, Montana, New Jersey, New Mexico, New York, North Carolina, North Dakota, Texas, West Virginia. Reasonable expectations has also been adopted by some courts as standard for equitable jurisdiction independent from the standard for "oppression".

The question remains if the reasonable expectation test is "the" new, exclusive, test. In Gimpel v. Bolstein the court found that when necessary both tests can be combined to define oppressive conduct. They could not use the reasonable expectation test because plaintiff inherited the shares and also stole form the corporation. (see infra III.E.4. for a comparative comment on the two standards)

Naturally, not every state switched over to the reasonable expectations standard. Michigan for instance did not for an interpretation of its statute granting equitable relief for "illegal, fraudulent or willfully unfair and oppressive" conduct. The showing required is that of a fault like fraud, abuse of trust or misappropriation of corporate funds.

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170 Michael E. DeBow, Oppression of minority shareholders: contract, no tort, 54 Ala. Law 128 (1993); See, Donald F. Clifford, Jr., Close Corporations Shareholder Reasonable Expectations: the larger context, 22 Wake Forest L. Rev. 41 (1987) (for a discussion of reasonable expectations in other branches of the law like contracts law, insurance law, law of tort and so on)
171 Topper v. Park Sheraton Pharmacy 433 N.Y.S. 2d 359 (N.Y.Sup. Court. 1980)
172 See e.g., Miller. supra note 162 at 234 n. 13; J.C. Bruno, "Reasonable expectations" -- a primer on an oppressive standard (part 1 of 2), 71 Mich. B.J. 434, 435-437 (1992) (discussing the cases); See also supra at note 146 Minnesota and North Dakota explicitly integrated the reasonable expectation standard in their legislation
173 North Carolina and California provide for minority relief when "reasonably necessary to protect the rights and interests" of the shareholder. See supra note 150
174 477 N.Y.S.2d 1014, 1020 (N.Y. Sup. Court. 1984)
176 Bruno, supra note 117 at 568
E. Reasonable Expectations

1. Creation and evolution of the reasonable expectations doctrine

Reasonable expectations is a standard adapted to the special expectations of close corporation actors i.e., expectations of active involvement, employment and return on investment. The first to suggest that “reasonable expectations” as standard for oppression in close corporations is Allen Afterman, an Australian scholar. In the U.S. Professor O'Neal has been the driving force behind the reasonable expectations standard. The reasonable expectations standard was also supported by an interpretation the House of Lords gave to the British Companies Act.

The New Jersey court in *Exadactilos v. Cinnaminson Realty Co.* is one of the first courts to explicitly use the expectations terminology and to link the expectations with the special close corporate context. The court refused relief because the plaintiff did not fulfill the expectations of the majority because he had not learned the business. But the standard was primarily developed by New York Courts like in *Topper v. Park Sheraton Pharmacy* where the court held that the discharge of a minority shareholder from his employment for cause and of his officer position was oppressive. That the shareholder was discharged for cause or as result of business judgment was irrelevant. The severe damage of expectations sufficient was the ground for oppression. Topper goes

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178 O'NEAL'S, CLOSE CORPORATIONS, *supra* note 2 at §9.29
179 Ebrahami v. Westbourne Galeries Ltd. 2 All E.R. [1972] 492. 2 W.L.R. 1289
180 400 A.2d 554, 560 (N.J. Super. Court 1979)(“The special circumstances, arrangements and personal relationships that frequently underlay the formation of close corporations generate certain expectations among the shareholders concerning their respective roles in corporate affairs, including management and earnings”)(the court also discussed the difference of expectations in a “large corporation” and in a “close corporation”).
181 433 N.Y.S. 2d 359 (N.Y. Sup. Court. 1980)
very far, too far for some in that it does not allow a legitimate business purpose to be a valid defense\textsuperscript{182}. From the beginning reasonable expectations has made the risk of abuse by the minority a serious threat.

The reasonable expectations standard is potentially to broad so it was necessary for courts to narrow it down. In \textit{Meiselman v. Meiselman}\textsuperscript{183} the court set some limits to the reasonable expectations standard. The plaintiff must prove that 1) he had reasonable expectations. 2) they must be substantial. 3) with the accent on the word "reasonable", only disclosed expectations will be taken into account. That is the expectations known or assumed by the other participants. 4) the frustration of expectations is not the result of plaintiffs fault and is in large part beyond his control 5) under all circumstances the plaintiff is entitled to some form of equitable relief. 6) reasonable expectations are those that developed throughout the "entire history of the participants relationship". “History” includes the “expectations at the inception of the participants relationship . . .and those as altered over time . . . Even the expectations which develop as the participants engage in course of dealing in conducting the affairs of the corporation”

Professor Thompson in his turn cited following considerations that shape relief when reasonable expectations is applied\textsuperscript{184}: 1) Expectations need not be evidenced by a written instrument. They can be gleaned from written document and conduct. The burden of proof remains on the plaintiff. 2) Expectations must be important to investor’s participation. The expectation must be “substantially” defeated. A case by case analysis is essential. 3) Expectations must be known to the other parties 4) Relevant expectations are those at inception of the enterprise and those that develop thereafter. Furthermore courts should not grant relief for failure to achieve expectations within a reasonable time

\textsuperscript{182} Bruno, \textit{supra} note 117 at 435
\textsuperscript{183} 307 S.E.2d 551 (N.C. 1983)
\textsuperscript{184} Thompson’s, \textit{dissolution, supra} note 23 at 215-228 (for the other considerations see infra. III.E.2. and 3. the disadvantages and advantages of reasonable expectations)
period. It would suffice that the majority shows that there is a significant probability that expectations will be fulfilled\textsuperscript{185}.

\textit{re Kemp & Beatly, Inc.}\textsuperscript{186} is a typical case of application of the reasonable expectations doctrine. The court limited expectations further in that it provided that it will not grant relief for frustrated expectations of a minority shareholder acting in bad faith. After the minority shareholders-employees were fired a long standing dividend policy of awarding de facto dividends was changed. A classical situation of “frozen-out” but “locked in” petitioner. The court granted dissolution and optional buy out. The court pointed out that to determine expectations a case by case approach is necessary. In fact expectations are not only those developed throughout the "entire history of the participants relationship” but are expanded to a corporation by corporation, shareholder by shareholder analysis.

An example of expansive interpretation of reasonable expectations is \textit{Pedro v. Pedro}\textsuperscript{187}. The court found in favor of a sympathetic plaintiff that reasonable expectations can include an implied agreement to provide lifetime employment. This, in total contradiction with the employment at will doctrine\textsuperscript{188}.

\textit{Burack v. I. Burack, Inc.}\textsuperscript{189} narrowed the standard further down by stating that "oppression should be deemed to arise only when the majority's conduct \textit{substantially} defeats expectations that, \textit{objectively} viewed, were both \textit{reasonable} under the circumstances and were \textit{central} to the petitioners decision to join the venture". Does

\begin{footnotesize}
\textsuperscript{185} Hillman, \textit{supra} note 136 at 79
\textsuperscript{186} 473 N.E.2d 1173 (N.Y. 1984)
\textsuperscript{187} 489 N.W.2d 798, 803 (Minn. Court. App. 1992)
\textsuperscript{188} See generally Sandra L. Schlafe, \textit{Pedro v. Pedro: consequences for closely held corporations and the at-will doctrine in Minnesota}, 76 Minn. L. Rev. 1071 (1992) (for a complete discussion of the clash between pedro and the at-will doctrine. Arguing that pedro goes too far)
\textsuperscript{189} 524 N.Y.S.2d 457 (N.Y. App. Div. 1988) (same statement was already made in re Kemp & Beatly)
\end{footnotesize}
"objectively viewed" replace a minority shareholder perspective or a "for the benefit of the corporation" perspective?

Obviously, reasonable expectations is a very broad concept. It was and still is necessary to narrow it down otherwise, corporate stability of investment will be put at stake. A too broad interpretation allocates the risk of corporate failure on the majority not able anymore to meet expectations of the minority. But the concept must remain broad enough to be able to meet the peculiar needs of minorities in close corporations. Is it not therefore that the concept was developed in first instance?

2. Advantages

Expectations is “the most reliable guide to a just solution of a dispute among shareholders . . . in the typical close corporations”190. The reasonable expectation standard sprang out of the perception of peculiarities of close corporations. The advocates of differential treatment for close corporations are the same that advocate the re standard191. Reasonable expectations “grounds the discussion in the particular context of a close corporation operating within statutory norms built for a larger enterprise”. The courts using the reasonable expectations standard are thus likely to pay attention to the specific aspects of close corporations192. Because the standard is tailored for close corporations it is adapted to many of the forms of oppression specific to close corporations. Participants who were actively involved and are suddenly excluded will be protected. Certainly, if the minority has invested the capital expecting full time remunerative employment or some

190 David C. Crago, Fiduciary duties and reasonable expectations cash-out mergers in close corporations, 49 Okla. L. Rev. 1, 12 n. 87 (citing, O’NEAL’S, CLOSE CORPORATIONS, supra note 2)
191 With Prof. O’Neal being the most vocal proponent
192 Thompson, Shareholder’s Cause, supra note 24 at 712-713
other return. But a passive investor in a close corporation will not be protected, nor mere policy differences.\textsuperscript{193}

The reasonable expectations standard also softens the protection of the business judgment rule.\textsuperscript{194} A reasonable expectations analysis preempts the business judgment rule. The absence of bad faith requirement for reasonable expectations proves this. Bad faith is typically used to rebut the business judgment rule presumption. Naturally, this does not eliminate the business judgment rule protection totally form every decision but only from those related to the alleged oppression.\textsuperscript{195}

Professor Thompson notes that the reasonable expectations standard "moves the focus away from the defendants wrongdoing and towards consideration of whether the plaintiff's rights and interests have been prejudiced."\textsuperscript{196} In other words it is not required to prove fault and misconduct to obtain relief. This is again, the absence of bad faith requirement. The influence of Hetherington's plea for elimination of the fault principle in granting relief is obvious.\textsuperscript{197} Plaintiffs misconduct on the other hand can provide a basis for denial of relief. A plaintiff acting in bad faith can not invoke his expectations. Courts can still use the fault based standard to grant relief for majority's "harsh and wrongful" conduct. A balance must be found between the need for relief and plaintiffs wrongful actions.

The reasonable expectation standard promotes bargaining and contract. Privately held expectations are not considered but only, at least implicitly, communicated

\begin{flushright}
\textsuperscript{193} O'NEAL'S, CLOSE CORPORATIONS, supra note 2 at § 9.29-9.30
\textsuperscript{194} Steven S. Bahls, Resolving Shareholder Dissension: Selection of the Appropriate Equitable Remedy, 15. J. Corp. L. 285, 322 (1990)
\textsuperscript{195} Peeples supra note 118 at 502- n.352-503
\textsuperscript{196} Thompson's, dissolution, supra note 23 at 219
\textsuperscript{197} Hetherington, Illiquidity, supra note 29 at 46
\end{flushright}
substantial expectations. Without a doubt, the clearest type of communication of expectations is to set those forth in a shareholder agreement\textsuperscript{198}.

The advantages of the reasonable expectations standard are thus numerous. The standards is tailored for close corporations. It focusses on the relationships and thus require an analysis of behavioral patterns over time and not of isolated events. Finally, it promotes bargain and does not require any showing of bad faith\textsuperscript{199}.

3. Disadvantages

a. Undefinedness of expectations

What the expectations of parties are is undefined. They can arise at any moment in the relationship. Dramatizing the situation one author spoke about the "casual comment trap"\textsuperscript{200}. The danger is that informal comments and subjective interpretations of comments will become binding for the majority because they are transformed into reasonable expectations. Mere good will and generosity of the majority could have the same effects. This in total contradiction with the principle that important decisions are formally taken by the board or the shareholders.

Tremendous problem of proof will arise since expectations have to be disclosed but not only in writing. Oral testimony about past conduct will be inevitable and will often contradict corporate documents\textsuperscript{201}.

\textsuperscript{198} Hillman, supra note 136 at 78
\textsuperscript{199} Peeples supra note 118 at 503
\textsuperscript{200} Bruno, supra note 117 at 437
\textsuperscript{201} Peeples supra note 118 at 503
Plaintiff's has limited expectations or they are sometimes not existent at all\textsuperscript{202}. This is the case if the plaintiff inherited the shares or received them as gift\textsuperscript{203}. He is a new element in the venture and “has no history of expectations”. Therefore in *Gimpel v. Bolstein*\textsuperscript{204} the court used the fault based test. The reasonable expectations test was not applicable. Likewise business may have changed so much over time that it is not possible to fulfill expectations any longer\textsuperscript{205}. On the other hand expectations is an evolving concept and should thus be able to cover those situations\textsuperscript{206}.

Some argue that there is a lack of mutuality. The majority does not reasonably expect from the minority to be “devoted, remain employed, perform duties, cooperate, vote shares or give bank guarantees”. Why then should the minority have such great expectations?\textsuperscript{207}

b. Not adapted to larger close corporations

Large close corporations are often composed of a relatively higher number of shareholders. Such corporations have a significant influence in the community where they are settled. This factors create expectations conflicts between the different groups of shareholders and even between conflicting minority interests\textsuperscript{208}. Vague expectations, even

\textsuperscript{202} Bruno, *supra* note 117 at 434 (cites following disadvantages 1) set unnecessary limits to the majority rights 2) underestimates acceptance and understanding of the risk undertaken by the minority 3) ignores awareness of majority that it has not unfettered power 4) negates the ability of the minority to negotiate its own protection 5) the minority has in fact limited expectations 6) existing protection of the minority are adequate)

\textsuperscript{203} Thompson, *Shareholder’s Cause, supra* note 24 at 712

\textsuperscript{204} 477 N.Y.S.2d 1014 (N.Y. Sup. Court. 1984)

\textsuperscript{205} Bahls, *supra* note 194 at 327

\textsuperscript{206} O’NEAL’S, CLOSE CORPORATIONS, *supra* note 2 at §9.30

\textsuperscript{207} Bruno, *supra* note 117 at 569

\textsuperscript{208} Miller, *supra* note 162 at 233, 254
e. Existing protection is adequate

The argument states that minority shareholders are perfectly aware of the risk their investment bear. They are therefore eager to use contractual agreements to protect themselves\(^{212}\). Examples of such protections are 1) provisions guaranteeing presence on the board or veto power 2) shareholders agreement for share purchase or dividend policy\(^{213}\). (infra.VI.C. For a brief discussion of the different protections) Statutory protection is found in the corporation act and in the securities regulations

f. Negates the agreement and eliminates risk taking for the minority

The adaptability of the reasonable expectations throughout time introduces a kind of rebus sic stantibus clause in the agreement. Due to changed circumstances the expectations have evolved to the extent that the minority does not have to perform anymore. Thus they withdraw their investment. The situation also resembles the more limited amendment “in the course of dealing”. A technique adapted to contract law but not to corporate law\(^{214}\). Moreover, to the extent reasonable expectations seeks to enforce non-written agreement it is in conflict with statutes making only such agreements in writing enforceable\(^{215}\). Furthermore, the primary goal of corporation law, i.e., to reduce the transaction cost by providing a set of standard implied contract terms so that firms do not have to restipulate these terms every time, is defeated by the reasonable expectations

\(^{212}\) Supra. II. and VI.B. most scholars contend that for several reasons parties do not use agreements extensively.

\(^{213}\) Bruno, supra note 117 at 566

\(^{214}\) Id. at 437-438

criterium\textsuperscript{216}. The fact that expectations protected are also those that arise after the purchase of the stock insulates the minority from market risks or the consequence of a bad bargain\textsuperscript{217}. The disappointed expectations are some times due to the poor bargain of the minority. Poor bargain should not be protected. Therefore a criterium is necessary that distinguishes between frustration of expectations and deception resulting from poor bargain. A proper balance must be found between reasonable expectations, legitimate business purpose and the enforcement of the contractual relationship of the parties\textsuperscript{218}.

A comment on risk allocation

The risk taking argument is one of the central dilemma’s of oppression. Defining who has to bear which risk is defining which standard for oppression is adapted.

When shareholders decide to incorporate, they in fact decide to share the risks related to the business. If things go wrong shareholders will try to withdraw without having to bear the losses and the frustrated expectations. This is why, some argue that, reasonable expectations eliminates the risk for the minority because they can withdraw so easily. The answer is not that clear. Everything depends under what conditions a shareholder is allowed to withdraw. Three principle guide this analysis: 1) No investment is eternal even not in a (potentially eternal) corporation. 2) All parties should share the risks equally. 3) Bad faith should not be protected. The solution in the two extremes is evident. If the minority is eliminated because of greed of the majority they should be protected because they have the right to share equally in the earnings of the company. On the other hand if a shareholder in bad faith tries to withdraw from bad business he should not be allowed to do so because he has to support, like all the others, the fact that things

\textsuperscript{216} Crago, supra note 215 at 26-27
\textsuperscript{217} Bruno, supra note 117 at 436
\textsuperscript{218} Miller, supra note 162 at 257-258
went wrong. The problem is when a (good faith) minority shareholder is squeezed out based on rational business decisions and legitimate business purpose. Different scenario’s can be imagined the minority shareholder is eliminated because parties can not work together anymore or because the corporation is not able to provide a job for this shareholder. In these scenarios we can also imagine a sub-scenario were although the minority shareholder has lost is employment the corporation still provides him with some return on investment by paying dividends. The risk of not being able to provide employment (a classical expectation) must be shared by all shareholders equally and not only by the minority. Therefore he should be able to withdraw. Moreover we cannot accept that a shareholder remains locked-in forever. But is it not that by allowing the minority to withdraw we force the majority to support all the risks alone, and even more risks to the extent that they are forced to buy unwanted shares from the minority? This is the price to pay for having minority capital. It would be unacceptable to have capital blocked for ever. Moreover if the business is failing the minority will carry the risk of that failure because it will receive a lower “fair price”. It is important that valuation of “fair price” includes the risk that party agree to take by joining the venture. Expectations go very far. In our case a corporation still providing a reasonable return on investment is still considered to frustrate the reasonable expectations of employment. Therefore the accent should be laid on the disclosure and the acceptance of expectations. Courts should be very strict before accepting implied expectations.

g. The reasonable expectations standard fails to incorporate the interest of non shareholders and an ethical consideration of “social responsibility”

This is the classical stakeholders argument. The corporation is perceived has having social responsibilities towards employee, public health and safety, environment and in a
larger sense the community. Non-shareholders considered to have an interest in the existence of the corporation are more than just the creditors. According to the stakeholders theory, dissolution based on reasonable expectations should not be granted as fast for instance to a corporation producing a medical device than to a corporation whose production causes pollution\textsuperscript{219}.

h. Legitimate business purpose

The limitations to the reasonable expectations criterium guarantee that no court will grant relief when there is bad faith of the minority\textsuperscript{220}. But what happens if the majority has a legitimate business purpose in frustrating good faith minority shareholders expectations? This question refers to the tension between the business judgment rule and reasonable expectations. Reasonable expectations eliminates the business judgment rule. A rule whose protection remains useful (even if not adapted) in close corporations to protect healthy business judgment\textsuperscript{221}. Recent cases acknowledge this problem by refusing to grant relief if the minority has any fault in the non fulfillment of expectations\textsuperscript{222}. But when expectations are frustrated without fault on either side and the majority has a legitimate business purpose no standard is available.

\textsuperscript{219} Miller, supra note 162 at 235, 255
\textsuperscript{220} re Kemp & Beatly, Inc. 473 N.E.2d 1173 (N.Y. 1984)
\textsuperscript{221} See Wilkes v. Springside Nursing Home, Inc., 353 N.E. 2d 657, 663 (1976) (recognizing “the fact that the controlling group . . . in a close corporation must have some room to maneuver in establishing the business policy”)
\textsuperscript{222} re Kemp & Beatly, Inc 473 N.E.2d 1173 (N.Y. 1984)
4. Evaluation of the different standards for oppression

The difference between the fault based test and reasonable expectations can be misleading. First courts do not refuse to combine the two. Second even in a reasonable expectation test a fault based analysis plays a role because courts will analyze the equity of the case, the fiduciary duties and the conduct of the parties. The two standards overlap often because breach of fiduciary duties is not only considered as a departure from the standard of fair dealing, but also as a conduct which frustrates reasonable expectations. Yet, the standards are not similar. Fair dealing refers to “harsh dishonest and wrongful” conduct while reasonable expectations is not fault-based.

The reasonable expectations analysis could be used as a basis for relief, independent oppression. This approach is to broad and would jeopardize the stability of corporations. When reasonable expectations is used as a method to define oppression there must be a relation to action by those in control and the frustration of the expectations of the minority. Therefore even if reasonable expectations is not fault based it is still linked to misconduct. While the California and the North Carolina statutes with “reasonably necessary for the protection of the rights and interest of the complaining shareholder” do not require any showing of misconduct. Stumpf v. C.E. Stumpf & Sons, Inc., illustrates this approach. A fired employee shareholder who did not receive any income from the corporation anymore was granted a decree of dissolution because a continuation of the corporation was not in his benefit or interest. But “rights and Interest” is a to vague criterium. And for the sake of the stability of the corporation a link with

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223 Miller, supra note 162 at 262
224 Thompson, Shareholder’s Cause, supra note 24 at 712
225 Thompson, Dissolution, supra note 23 at 209
226 Hillman, supra note 136 at 56
227 47 Cal. App. 3d 230 (Court. App. 1975) (even in this case an (unnecessary) reference to ‘‘fairness’’ was made)
misconduct (not fault) remains useful. “Rights and interest” is totally separate from any course of conduct. It goes to far and is to burdensome for the majority. Decisions to grant relief would be totally arbitrary. The link with misconduct, in the sense of frustration of expectations is certainly necessary when those decisions are based on a legitimate business purpose. Finally, there is a policy consideration supporting reasonable expectations. Reasonable expectations protect the non contracting shareholder. An approach rejected for instance by Delaware. This pro-management state insist on the contractual liberty of parties and their bargain. We saw however that parties are often not able to contract in the close corporate context.
Chapter IV. Expansion of Fiduciary Duties

A. A borrowed concept

The concept of fiduciary duties is a concept derived from the law of trusts. It is a vague undefined concept, derived from some standards of "good behavior". Fiduciary duties generally require "good faith and fair dealing".

Directors have had since a long time fiduciary duties toward the corporation and the shareholders. A duty of fairness owed by the majority or controlling group to the minority has also been recognized. This duty, even though recognized, has not gained wide acceptance in the beginning. Recently, courts have changed their attitude and recognized a duty of the majority, especially in small close corporations. In that context the courts have heightened the traditional standard of duty owed.

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228 Henry F. Johnson, Strict Fiduciary Duties in Close Corporation: A Concept in Search of Adoption, 18 Cal. Western L. Rev. 1, 3 (1981) ("A trust is a relation of total custody, effected by appropriation of an asset, giving rise to duties directed to the benefit of the beneficiary")

229 HENN, supra note 19 at 627 ("fiduciary duties and their correlative rights are an abstraction unless defined in terms of their persons of inherence and of incidence, their subject matter, and the acts of forbearances they require")

230 Johnson supra note 228 at 2

231 Southern Pacific Co. v. Bogert, 250 U.S. 483 (1919); See O'NEAL'S OPPRESSION, supra note 104 at §7:17 n. 13 (for a discussion of all the cases where a duty form the controlling group towards the minority has been found)

232 But See as a general rule shareholders do not owe each other or to the corporation any duty, P. A. Agabin, Annotation, Duty and liability of closely held corporation, its directors, officers, or majority stockholders, in acquiring stock of minority shareholder, 7 A.L.R. 3d 500 n. 5 (suppl. 1996); Thomas J. Bamonte, Expanding the fiduciary duties of close corporation shareholders: the dilemma facing Illinois corporate law, 15 N. Ill. U. L. Rev. 257 (1995); See also generally for a description of the early evolution of the concept of fiduciary duty, Rodman Elfin, A critique of the proposed statutory close corporation supplement to the model business corporation act, 8 J. Corp L. 439, 454-456 (1983)
This expansion of fiduciary duties is in first instance supported by the partnership analogy. Proponents of the analogy note that the characteristics and especially the relationships in partnerships are identical to those in close corporations. Therefore principles of partnerships, like heightened standards of fiduciary duties, should apply in close corporations (Supra II.B.2.). Through this approach courts can guarantee an "equal treatment" for frozen out minority shareholders. The corporation is on its turn also protected against an errant shareholder.

Heightened partner-like fiduciary duties limit the right of control of the majority and the protection of the business judgment rule. The duty of care in close corporations is more than the mere process duty it is in a public corporation. The substance of the business decision is weighted against a concept of fairness and loyalty whenever the minority is harmed. However, to the extent courts accept a showing of legitimate business purpose they try to compromise between the two concepts. This showing allows the controlling group to withhold some room to maneuver in establishing business policies.

Finally we note that from the beginning there has been a (rather academic) discussion concerning the nature of the action for breach of fiduciary duty: contract or

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233 Crago, supra note 215 at 7-8
234 Bamonte, supra note 232 at 259
235 Smith v. Atlantic Properties, Inc., 422 N.E.2d 798 (Mass. App. Ct. 1981) (a minority shareholder was held to have breached its fiduciary duty when he exercised a veto power in a way that did not take into account the reasonable expectations of the majority); Bamonte, supra note 232 at 260: O’NEAL’S OPPRESSION, supra note 104 at §7:17 (a duty is certainly imposed upon the minority if the minority has received veto powers)
236 HENN, supra note 19 at 628 (“Breach of fiduciary duty to the corporation precludes application of the business judgment rule”)
237 But see Justis, supra note 15 at 264 (but public corporations with some characteristics of close corporations maybe held to have the same fiduciary duties)
238 Ivery D. Foreman, Re-defining Close Corporations, 78 -MAR A.B.A. J. 76 (1992)
tort.\textsuperscript{240} In the contract approach the minority is able to waive contractually the fiduciary duties owed by the majority.\textsuperscript{241}

\textbf{B. An enhanced standard in close corporations}

In the landmark decision, \textit{Donahue v. Rodd Electrotype Co.}\textsuperscript{242} the court decided that the special relationships and needs of close corporations\textsuperscript{243} motivated that an enhanced standard of fiduciary duty is applied on them. The same strict standard of “utmost good faith and loyalty” that is used in partnerships. Thus, the court decided that the minority shareholder should get an “equal opportunity” to sell her shares to the majority as a former director received.

In \textit{Wilkes v. Springside Nursing Home, Inc.},\textsuperscript{244} the Massachusetts court extended the application of the Donahue strict standard of fiduciary duties from a share purchase situation to the freeze out context. The employment of the minority shareholder had been terminated by the majority in disrespect of an understanding that the four shareholders would elect each other as directors and would actively participate in the management. Wilkes was excluded from any company income. Donahue was tempered in that the court in Wilkes allowed the showing of a legitimate business purpose. Purpose that must on its turn be balanced against less harmful alternatives. Thus fiduciary duties are limited by

\textsuperscript{241} De Bow \textit{supra} note 240 at 130
\textsuperscript{242} 367 Mass. 578, 328 N.E.2d 505 (1975)
\textsuperscript{243} See \textit{supra} at II. A. for a definition of close corporations by the Donahue court.
\textsuperscript{244} 370 Mass. 842, 353 N.E. 2d 657 (1976)
evaluation of intent and wrongdoing of the majority in terms of specific harm to the minority.\textsuperscript{245}

In Orchard \textit{v.} Covelli\textsuperscript{246} the court used the stringent standard of "utmost good faith and loyalty" and added that any "squeeze out" attempt through self-dealing would constitute a breach of fiduciary duty. Moreover the majority has to be "intrinsically fair" to the minority when it seeks a controlling share. A standard different from Donahue and Wilkes? Presumably not so different as to the results\textsuperscript{247}. The duty of this standard is phrased as one not to exclude shareholders from meaningful participation\textsuperscript{248}.

Other states also imposed strict fiduciary duties on shareholders\textsuperscript{249}. In Hagshenas \textit{v.} Gaylord\textsuperscript{250} the Illinois court finally adopted the strict standard of fiduciary duty. This decision was reached after the court addressed the partnership analogy\textsuperscript{251}. A similar decision was taken by the Ohio Supreme Court in Crosby \textit{v.} Beam\textsuperscript{252} where the heightened standard of fiduciary duties was breached because benefit from advantages where not made equally available to the minority. Like in Wilkes the majority carried the burden of proof of legitimate business purpose. The decision has introduced a new exception to the employment at will doctrine\textsuperscript{253}. Note that a New York court held that no

\textsuperscript{245} Kathleen L. Kuhlman, Comment, \textit{Beyond Crosby v. Beam: Ohio courts extend protection of minority stockholders of close corporations}, 27 Akron L. Rev. 477, 480 (1994) (for instance, has a personal advantage not been made equally available to the minority)
\textsuperscript{246} 590 F. Supp. 1548 (W. D. Penn. 1984), aff'd, 802 F. 2d 448 (3rd Cir. 1986)
\textsuperscript{247} L. Clark Hicks, \textit{Corporation -- Fiduciary duty -- in a close corporation, a majority shareholder owes a fiduciary duty towards a minority when seeking a controlling share}, 60 Miss. L. J. 425, 438 (1990)
\textsuperscript{248} Thompson, \textit{Shareholder's Cause}, supra note 24 at 728
\textsuperscript{249} Hicks, \textit{ supra} note 247 at 427 n. 55 (Citing jurisdiction who follow the strict standard of fiduciary duty in close corporations)
\textsuperscript{250} 557 N.E.2d 316 (Ill. App. Ct. 1990)
\textsuperscript{251} The court stated that Hagshenas owed a duty “similar to a partner” to the corporation and its shareholders
\textsuperscript{252} 548 N.E.2d 217 (Ohio 1989)
fiduciary duty precluded termination of employment\textsuperscript{254}. Shareholders employment and fiduciary duties remains a heavy litigated issue\textsuperscript{255}.

Some states refuse the strict fiduciary duties standard. In \textit{Ziddel v. Ziddel}\textsuperscript{256} the intrusive approach into business judgment of Wilkes was rejected in favor of deference to the business judgment rule. The same respect for business judgment guided the decision in \textit{Johns v. Caldwell}\textsuperscript{257}. The court refused the partnership analogy argument and did not prevent a 10% shareholder to sell his shares to a 45% shareholder. This courts refused to apply the Donahue standard or to find an equal opportunity in the right to sell\textsuperscript{258}.

Delaware, as pro-management state rejected expansion of fiduciary duties in close corporations\textsuperscript{259}. Delaware is in general very cautious with oppression remedies so as to attract corporations. The decision where to incorporate is presumably made by the majority shareholders. Moreover, Delaware has well developed standards of fiduciary duties for public corporations, by refusing to apply stricter standards in close corporations it preserves its competitive advantage and its body of case law\textsuperscript{260}.

Even if there are differences of interpretation of the scope and meaning of the Donahue fiduciary duty standard, it can be stated that the standard has gained widespread acceptance\textsuperscript{261}. In North Dakota and Minnesota the statutes expressly mention the heightened standard of fiduciary duties for close corporations\textsuperscript{262}. It has also been

\textsuperscript{254} Gallager v. Lampert, 549 N.E. 2d 136 (N.Y. 1989)
\textsuperscript{255} Thompson, \textit{Shareholder’s Cause}, \textit{supra} note 24 at 729
\textsuperscript{256} 277 Or. 413, 560 P.2d 1086 (1977)
\textsuperscript{257} 601 S.W.2d 37 (Tenn. Ct. App. 1983)
\textsuperscript{259} Nixon, v. Blackwell, 626 A. 2d 1366 (Del. 1993)
\textsuperscript{260} Bamonte, \textit{supra} note 232 at 266
\textsuperscript{261} Thompson, \textit{Shareholder’s Cause}, \textit{supra} note 24 at 729
\textsuperscript{262} Minn. Stat. Ann. § 302A.751(3) (a); N.D. Cent. Code § 10-19.1-115(3)
suggested to add an express provision in the close corporations supplement. The enhanced duty, however, is limited by three principles: 1) the corporation must be a close corporation 2) the relationship between shareholders must be that of partners 3) no legitimate business purpose explains the decision.

C. Fiduciary duties, oppression and reasonable expectations: parallel, intermingled or distinct?

Oppression defined as reasonable expectations and heightened fiduciary duty have in common the willingness of courts to help squeezed out minority shareholders. This is proven by the fact that fiduciary duties have often been extended faster in states who do not have an “oppression statute” or a dissolution remedy. A way for these courts to grant some protections to minority shareholders in a statutory difficult environment. Therefore it might be argued that the interpretation of fiduciary duties in states without oppression statutes is not applicable in those having one. Both cause of action developed in parallel.

The “reasonable expectations” standard has also been used to determine breach of fiduciary duty. Thus some courts use the same standard to determine “oppression” in a

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264 Murdock, *supra* note 31 at 436

265 Bamonte, *supra* note 232 at 260

266 Thompson, *Shareholder’s Cause, supra* note 24 at 700

267 Bamonte, *supra* note 232 at 266 n. 50

dissolution or alternative remedy case as in a breach of fiduciary duty case\textsuperscript{269}. The advantage of “reasonable expectations” as the standard for breach of fiduciary duties is that it helps to determine the otherwise vague duties owed by the majority\textsuperscript{270}. Here the parallelism of both action is broken. The scope of facts they cover is identical.

In other jurisdictions breach of fiduciary duty is independent and not related to the reasonable expectation standard. Breach of fiduciary duty is then defined as a departure from some standards of good faith and loyalty. Even when the two standards coexist separately, breach of fiduciary duty often also amounts to a frustration of reasonable expectations\textsuperscript{271}. Therefore a combined cause of action for oppression is possible based on the same facts. An action for breach of duty and one to request dissolution or the application of an alternative remedy based on statutory “oppression”\textsuperscript{272}. The differences between the two actions must be kept in mind when choosing the appropriate approach. As we said the development of the two avenue for relief have been different in states depending on their availability. Some states have no statutory cause of action for oppression and tend to have broad fiduciary obligations. While in other states the direct common law remedies have not been well developed because of the oppression statutes\textsuperscript{273}. The availability of remedies also plays a great role in the procedural choice. It makes no sense to request dissolution when a corporation is financially broke while an order compelling a shareholder to deliver something he had agreed to might save the corporation. Remedies available under the two causes of action are not identical. In breach of fiduciary action courts retain equitable powers. Powers that are more restricted in the statutory context. Although neither the courts nor the scholars agree to what extent.

\textsuperscript{269} Thompson, Shareholder’s Cause, supra note 24 at 700
\textsuperscript{271} Thompson, Shareholder’s Cause, supra note 24 at 712
\textsuperscript{272} Id. at 739
\textsuperscript{273} Id.
The breach of duty cause of action will be more used in an ongoing relationship for recovery while an action for recovery based on dissolution and buy out is obviously meant to terminate the relationship.\textsuperscript{274}

D. Necessity of a heightened standard?

The acceptance of heightened fiduciary duties relies heavily on the partnership analogy. An analogy whose accuracy can be doubted. Some weaknesses of the analogy have already been discussed above (Supra. II.B.2.). Other arguments strengthen this critique. Closely knit relationships of partnerships are not always present in close corporation with great numbers of shareholders. Close corporations are sometimes composed of an impressive number of participants.\textsuperscript{275} Moreover, because of the limited liability protection in corporation the same mutual cooperation is not required automatically as it is the case in partnerships where a partner can bind the whole partnership.\textsuperscript{276}

Like for the reasonable expectations standard opponents of expanded fiduciary duties point out that shareholders have enough possibilities to protect themselves through private contracting.\textsuperscript{277} Easterbrook and Fischel disagree with the proposition that differences between close- and public corporation induce automatically the necessity of different level of scrutiny. Managers in close corporation bear more the costs of their decisions and the low number of shareholders facilitate contractual agreements. This features seem to suggest that greater scrutiny is needed in public corporations. Therefore

\textsuperscript{274} Thompson, \textit{Shareholder's Cause}, supra note 24 at 730
\textsuperscript{275} Kates \textit{supra} note 270 at 659-660 (citing, Hillman, \textit{supra} note 136 at 61-68)
\textsuperscript{276} \textit{ld.}
\textsuperscript{277} EASTERBROOK'S, CORPORATE LAW, \textit{supra} note 5 at 234-236
they suggest to use in both corporation the same standard of review but to apply them differently because of structural differences of organization. Hence, a termination of employment in a close corporation will be evaluated with more scrutiny by courts because it can have terrible consequences in that context. They do not plead for different standard of fiduciary duty but for a differentiated application of the business judgment rule\textsuperscript{278}. A semantic difference?

Easterbrook and Fischel also critisized the idea that one aspect of fiducairy duties is that shareholders have to be treated equally. The "equal opportunity" standard developed by the Donahue court is unrealisic. How could all shareholders receive an equal salary, share or position. Not surprisingly, was the standard restricted in Wilkes\textsuperscript{279}.

The expansion of the standard is an attempt of courts in a often legal difficult context to protect minorities. The problem is that the fiduciary standards are vague and even more undefined than reasonable expectations. The partnership analogy although interesting is not accurate. Fiduciary duty is a cause of uncertainty. Therefore the better adapted reasonable expectation and oppression cause of action should be preffered. A standard that is broad enough and does not need to be completed. Certainly, if the broad range of alternative equitable reliefs available with a fiduciary duty action are also in a classical oppression action.

E. Equitable remedies in fiduciary duty actions

The recognition of a stricter standard of fiduciary duty by the Donahue court is linked with the lack of relief available at that time in close corporations. The court

\textsuperscript{278} \textit{Id.} at 243-245
\textsuperscript{279} \textit{Id.} at 247
conceived direct action as a “rescue operation” for minority shareholders. The Donahue case opened the way for courts to fashion equitable reliefs. The forms of relief available will depend on the type of harm suffered. Difference in availability of relief will often determine the course of action of the parties: breach of fiduciary duties or statutory “oppression”. The importance of the heightened standard of fiduciary duty, thus lays principally in the many equitable reliefs it made available.

F. Direct actions for derivative harm

In a derivative proceeding the plaintiff sues in the name of corporation, while in a direct action he files suit on his own behalf. Because a derivative suit is an exceptional procedure in that it allows a shareholder to speak for the corporation and not the board, many procedural hurdles have to be overcome. The lack of independent directors in close corporations, however, diminishes those hurdles.

The implications of a derivative procedure are obvious. Damages and compensation will go to the corporation, who is controlled by the majority. In minority oppression cases derivative action makes little sense. Derivative litigation is used when the shareholder is harmed only indirectly by a reduction of the value of his shares. Most breach of fiduciary duty litigation are brought by shareholders derivatively. Like claims for mismanagement, negligence and misappropriation.

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281 Zimmerman v. Bogoff, 402 Mass. 650, 661 (1988) (The court “exercising its traditional equity powers” will try to put “the innocent partner . . . as nearly as possible in the same position which he would have occupied if there have been no wrongdoing”)
282 HENN, supra note 19 at 1044-1046 (for a general discussion of direct and derivative action)
283 Kates supra note 270 at 661
Direct action is theoretically only authorized when the harm to the shareholder is separate and distinct from injury to the corporations \(^{284}\). This concern mostly claims based on "rights". However, in a close corporation injury to the corporation may have a clear and discernable impact on an individual shareholder, because shareholders are few and the financial affairs of the corporation are relatively uncomplicated\(^{285}\). This is why, although, generally a shareholder seeking to recover for breach of fiduciary duty by a controlling shareholder must bring a derivative action, courts have recently been willing to accept direct actions from individually harmed minority shareholders\(^{286}\).

In *Crosby v. Beam*\(^{287}\), a breach of fiduciary duty towards the minority shareholders gave a right of direct action. The partnership analogy developed in Donahue was fully embraced by the court to motivate its decision. The court recognized that a claim for misappropriation of corporate funds is traditionally a derivative claim since the shareholders is only harmed indirectly but that the special characteristics of close corporation and the direct fiduciary duties of the majority motivated a derogation. The dissent pointed out that the right to sue directly was to broadly formulated and should have been limited to squeeze out situation\(^{288}\).

The recognition of the rights of direct action are also partially rooted in the partnership analogy. A partner (thus also a shareholder in a close corporation) harmed by another partner/shareholder can sue directly. However, this vision ignores that, unlike a partnership, a corporation is a separate legal entity capable to sue, and thus harm to the corporation must be brought derivatively\(^{289}\). This argument on its turn is weakened by the

\(^{284}\) Billings *supra* note 280, 596 at 12

\(^{285}\) *Id.*


\(^{287}\) 548 N.E.2d 217 (Ohio 1989)

\(^{288}\) *Id.* at 223 (Wright, J., concurring in part and dissenting in part)

\(^{289}\) Johnson v. Gilbert 621 P.2d 916, 917 ( Ariz. Ct. App. 1980) (reasoning that since the two parties operated the corporation more as partners, partnership law applied); Kates *supra* note 270 at 651-652
consideration that the recognition of a duty from the majority to the minority in a
corporation supports direct action\textsuperscript{290}.

Thus a growing number of courts accept direct action in close corporation when
those actions in a public corporation setting should have been brought derivatively. The
disproportionate impact that the majority decision has in close corporations motivates this
approach. In fact courts accept nowadays “an individual cause of action for
oppression”\textsuperscript{291}. The American Law Institute’s principles of corporate governance support
direct action, be it in the limited situation where this does not harm other shareholders
and creditors\textsuperscript{292}. Delaware, not surprisingly, refused to recognize a direct cause of action
for oppression\textsuperscript{293}.

Nonetheless, many policy reasons favor the use of derivative actions. Reasons that
should be weighted before adhering to the clearer direct litigation procedure. The
corporation is a separate entity. A minority direct action permits the minority to ignore the
separate legal entity at the moment the entity collects return on investment while the rest
of the time the minority benefited from this legal personality. Moreover, direct action
harms creditors. They are forced to support risks greater than what they had bargained for.
Fellow shareholders may also be deprived from equal benefits of the recovery. Finally,
direct action diminishes the possibility that stakeholder interests and societal
considerations will be taken into account\textsuperscript{294}.

Therefore a narrower standard to define when direct litigation is permitted has been
suggested. The “realistic objectives” standard allows in “exceptional situations” the use

\textsuperscript{290} Steelman v. Mallory, 716 P.2d 1282 (Idaho 1986)
\textsuperscript{291} Thompson, Shareholder’s Cause, supra note 24 at 736
\textsuperscript{292} American Law Institute, Principles of Corporate Governance: Analysis and Recommendations §7.01(d)
(1994)
\textsuperscript{293} Bagdon v. Bridgestone/Firestone, Inc., 916 F.2d 379 (7th Cir. 1990) (federal court applying Delaware
law)
\textsuperscript{294} Kates supra note 270 at 661-663
of direct litigation. Broadly, "realistic objectives" will not be fulfilled if the majority shareholder/wrongdoer will benefit from the corporate recovery. This criteria, on its turn, has been replaced by a narrower allowing direct action if interested parties such as creditors other directors and shareholders, are not prejudiced\textsuperscript{295}.

The policy considerations described above are certainly legitimate. However, in a situation where a derivative procedure does not allow to threaten the scheme of oppression of the majority, the action is meaningless. In such case direct action is indispensable. Naturally, alternative pleading of direct and derivative action is possible. In a situation where defendant breached duties to the corporation and to the shareholders both action can be successfully combined\textsuperscript{296}.

\textsuperscript{295} \textit{Id.} at 663-665

\textsuperscript{296} Billings \textit{supra} note 280, 596 at 12
Chapter V. Judicial dissolution

A. Grounds for dissolution

1. kinds of dissolution

Three different kinds of dissolution are defined in corporate statutes:

1) Voluntary dissolution. All states provide for voluntary dissolution. Usually proposed by the board and approved by a majority or two thirds of shareholders. Thus the majority has power, like a partner, to dissolve the corporation at will. A right the minority does not have. Voluntary dissolution can be used by the majority to squeeze out minority shareholders. Usually in that case a company controlled by the majority will buy the liquidated assets. Abuse by the majority of voluntary dissolution to squeeze out minority can constitute breach of fiduciary duty. Voluntary dissolution questions the permanence of corporation, however in a way consistent with the majority rule. A unanimity vote requirement has been proposed for involuntary dissolution in close corporations. Unanimity would have terrible consequences. Any shareholder could veto dissolution. This requirement does not really preserve the corporate community contrary

297 Model Bus. Corp. Act § 14.02
298 Thompson, dissolution, supra note 23 at 200
299 O’NEAL’S, OPPRESSION, supra note 104 at § 5:21
300 Thompson, dissolution, supra note 23 at 200-201; O’NEAL’S, CLOSE CORPORATIONS, supra note 2 at § 9.27
to what is suggested by its proponents. A little bit like divorce laws requiring unanimous consent do not preserve marriages\(^301\).

2) Administrative dissolution by the secretary of state for unpaid due taxes and other essential corporate formalities\(^302\).

3) Finally, court ordered dissolution

2. Statutory grounds for judicial dissolution

The MBCA provides that the Attorney General, a shareholder or a creditor can request judicial dissolution each on different grounds\(^303\). Nowadays, every state has a dissolution provision. All but six states allow a shareholder to bring an action for judicial dissolution. Delaware, Kansas, Oklahoma, and Puerto Rico do not provide for shareholder action. However, in these states dissolution proceedings may be brought by the attorney general “upon his own motion or upon the relation of a proper party”\(^304\). The Illinois act of 1933 allowing shareholder to petition for dissolution served as a model for other corporation acts\(^305\).

The first dissolution statute were limited to situation involving the occurrence of a threat of irreparable injury. Nowadays the grounds have been broadened to include deadlock, illegality, fraud, or waste\(^306\). The MBCA permits shareholder action if the directors are deadlocked in management or the shareholders are deadlocked in voting

\(^{301}\) O'Neill, *supra* note 17 at 700-701

\(^{302}\) Model Bus. Corp. Act § 14.20

\(^{303}\) *Id.* at § 14.30

\(^{304}\) *Id.* at § 14.30 (statutory comparison); *But see* Gen. Corp. L. of Del. §226, 352; 353 corporate dissolution of close corporations by appointment of a receiver in case of insolvency, failure of corporate purpose, imminent danger of great loss resulting from irreparable division of the board of directors, *see generally* for a discussion of Delaware law, Siedel, *supra* note 19 at 427.

\(^{305}\) Murdock, *supra* note 31 at 440

\(^{306}\) Model Bus. Corp. Act § 14.30 (Historical background)
powers. In case of “illegal oppressive or fraudulent conduct” by the “directors or those in control of the corporation” similar action is possible. Finally, judicial dissolution can be requested when corporate assets are “misapplied or wasted”\textsuperscript{307}. The close corporation “supplement” provides the same ground for dissolution as the MBCA\textsuperscript{308}. Additionally the “supplement” provides that dissolution can be granted “if all other relief ordered by the court under section 41 (the laundry list of ordinary reliefs) or 42 (the buy-out remedy) has failed to resolve the matters in dispute”\textsuperscript{309}. The judge retains discretionary power. He “may” dissolve the corporation\textsuperscript{310}.  

In any case dissolution must be considered “appropriate as a last resort after other possibilities of resolving the dispute have failed”\textsuperscript{311}. This negative tone of comment is regrettable. It slows down efforts to make dissolution more acceptable to courts\textsuperscript{312}. Nevertheless, the MBCA and the “supplement” can in general be considered as promoting reliefs including dissolution. This goal is achieved with provisions providing broader grounds for reliefs compared with the timidity of other statutes and also the provisions providing a flexible list of alternative remedies. The broadening of dissolution grounds evolved in parallel with the acceptance of alternative remedies\textsuperscript{313}. Some states like for instance, North Carolina consciously eliminated the available alternative remedies from their statutes thereby increasing courts reluctance to order dissolution\textsuperscript{314}.

\textsuperscript{307} Id. at § 14.30 (2)
\textsuperscript{308} Model Stat. Close Corp. Supp. § 43(a)(1)
\textsuperscript{309} Id. at § 43(a)(2)
\textsuperscript{310} Model Bus. Corp. Act § 14.30 (official comment) (emphasizing the discretionary power of the court)
\textsuperscript{312} Bradley, supra note 80 at 836, 840
\textsuperscript{313} O’Neill, supra note 17 at 694
\textsuperscript{314} See generally, Robert Savage McLean, Minority shareholders rights in the close corporation under the new North Carolina business corporation act, 68 N.C.L. Rev. 1109, 1120-1125 (1990) (discussing the elimination of alternative reliefs and the influence on the use of dissolution)
The first ground for dissolution in a proceeding by a shareholder is deadlock. Deadlock\textsuperscript{315} (on which this thesis does not focus) is by definition a dead end situation. In that case a definitive solution is badly needed. The corporation will otherwise turn into a deadweight for the shareholders and the economy. Therefore deadlock developed as the first and most important ground for dissolution\textsuperscript{316}. Deadlock can be defined as “corporate paralysis of such a magnitude that the corporation simply cannot function, and is in danger of imminent financial disaster”\textsuperscript{317}. Cases have broadened interpretation of the term such as to include deadlocks due to super-majority votes and not only due to 50%/50% splits. Showing of irreparable injury is usually required for a management deadlock but not for a shareholders deadlock\textsuperscript{318}.

Grounds for dissolution like “waste and misapplication of assets” are most of the time combined by courts with “illegality and fraud”. The situation covered by those grounds are excessive salaries, payment of personal debts and other situations involving self-dealing\textsuperscript{319}.

Finally, oppression is the ground for dissolution we focus on. Only a dozen states have not included oppression as a ground for dissolution\textsuperscript{320}. (See supra. III. for a

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\textsuperscript{315} See generally, Stuart L. Pachman, Corporation evenly divided: judicial remedies for equal shareholders, 24 Seton Hall L. Rev. 234 (1993) (for a discussion focussing on the problems of deadlock, with emphasis on the buy out remedy)

\textsuperscript{316} Harry J. Haynsworth, The effectiveness of involuntary dissolution suits as a remedy for close corporation dissension, 35.1 Clev. St. L. Rev. 25, 33 (1987); Linda L. Shapiro, Involuntary dissolution of close corporations for mistreatment of minority shareholders, 60 Wash. U. L. Q. 1119, 1130 (1983); See also Israels, Sacred cow, supra note 18 (discussing the early reluctance of courts to even grant dissolution for deadlock”)

\textsuperscript{317} Id. at 31

\textsuperscript{318} Model Bus. Corp. Act § 14.30 (2)

\textsuperscript{319} Haynsworth, supra note 316 at 35

\textsuperscript{320} Hunter J. Brownlee, Comment ,The shareholders agreement: a contractual alternative to oppression as a ground for dissolution, 24 Stetson L. Rev. 267, 272 (1994) “(thirteen states do not authorize dissolution for oppression, unfair behavior or the protection of minority shareholders. Among this group of thirteen, six jurisdiction allow dissolution only when shareholders or directors are deadlocked in the management of their corporation. Four states permit dissolution for illegal and fraudulent conduct. Lastly, three states, most notably Delaware, do not allow minority shareholders to dissolve for any reason”); Thompson, Shareholder’s Cause, supra note 24 at 709 n. 70 (for a list of those states)
discussion of “oppression” as a cause of action for dissolution). The official comment warns that the “abuse of power” provisions should be used with caution “so as to limit them to genuine abuse rather than instances of acceptable tactics in a power struggle for control of a corporation.”

Connecticut uses the broadest terms, permitting relief for “any good and sufficient reason.”

The grounds for dissolution are since a few years broad enough. This is especially due to the development of a broader interpretation of the “oppression” ground. Rest to see if courts are willing to respect and use the statutes.

3. Equity grounds

Courts have slowly recognized that there is an equity ground for shareholders dissolution action. Till the end of the 19th century shareholder dissension was legally ignored. Since incorporation was a rare privilege and legislature created corporation, judicial reluctance to dissolve was comprehensible. But English courts recognized in an early stage their power to fashion equitable relief in shareholder suits so as to allow “complete relief.” Thus equity legitimated a wide variety of reliefs. The Michigan Supreme Court was the first to dissolve a corporation in the case of Miner v. Belle Isle Ice Co. so as to grant “complete relief”. In this first case the ground for dissolution was fraud.

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321 I.e., acting “illegally, oppressively, or fraudulently” (section 14.30(2)(ii)) and corporate assets being “misapplied or wasted” (section 14.30(2)(iv)).
322 Model Bus. Corp. Act § 14.30 (official comment 2. b.)
324 See also Israels, Sacred cow, supra note 18 at 781 (“courts of many states have held they have no power - absent statute- to dissolve”)
325 Hitchens v. Congreve, 4 Russ. 562, 38 Eng. Rep. 917 (Ch. 1828)
326 93 Mich. 97, 53 N.W. 218 (1892)
The Supreme Court of Florida for instance in Mills Development Corp. v. Shipp & Head Inc.,\textsuperscript{327} recognized her equity power to wind up a corporation if the corporate assets are in danger of being mismanaged or lost due to the “mismanagement, collusion or fraud” of controlling shareholders. In this early case, the court stated that dissolution would only be ordered if the corporation has ceased conducting most of its business or is unable to function. The same court in MacAllister Hotel, Inc. v. Schatzberg\textsuperscript{328} adopted later on a two prong test to dissolve a corporation in equity. In a first step they applied a variation of the mismanagement and fraud test of Mills. The second prong evaluated the solvency of the offending shareholder. Absent fraud a corporation will only be dissolved for egregious misconduct if the shareholder is insolvent. Florida courts have generally refused to dissolve corporations for freeze outs\textsuperscript{329}. In Hill v. Bellevue Gardens, Inc.,\textsuperscript{330} the court was willing to order dissolution because the managers run the company for their own benefit. Other courts like for instance, New York courts, are very reluctant to order dissolution and usually require wrongful intent\textsuperscript{331}.

Dissolution statutes where in fact enacted to make an end to the reluctance of courts to use the dissolution remedy in dramatic situations\textsuperscript{332}. Therefore it is erroneous to deduct that statutory grounds and remedies limit the equity powers of the courts\textsuperscript{333}. Most courts have acknowledged this but some with New York in the lead consider their powers to be limited by the reliefs listed in the statute.\textsuperscript{334} Another uncertainty is created by the broader

\textsuperscript{327} 171 So. 533 (Fla. 1936), cert. denied, 305 U.S. 658 (1938)
\textsuperscript{328} 40 So. 2d 201 (Fla. 1949)
\textsuperscript{329} Keck v. Schumacher, 198 So. 2d 39 (Fla. Dist. Ct. App.), cert. denied, 204 So. 2d 210 (Fla. 1967); Brownlee, supra note 320 at 283 (see also generally for a discussion of the cases in Florida)
\textsuperscript{330} 297 F.2d 185 (D.C. Cir. 1961)
\textsuperscript{331} Leibert v. Clapp, 13 N.Y.2d 313, 196 N.E.2d 540 (1963)
\textsuperscript{332} O’NEAL’S, OPPRESSION, supra note 104 at §7:21
\textsuperscript{333} Bahls, supra note 194 at 313-315
\textsuperscript{334} E.g. re Field, Rich & Associates, 134 Misc. 2d 216, 217, 510 N.Y.S.2d 47, 48 (N.Y. Sup. Ct. 1986); See also for instance, Robert Savage McLean, Minority shareholders rights in the close corporation under the new North Carolina business corporation act, 68 N.C.L. Rev. 1109, 1122-1123 (1990) ("Despite the clear
remedies (and sometimes grounds) provided in close corporations statutes. Those remedies (and grounds) are not provided in the general corporate law. The "supplement" explicitly states that "This Supplement does not repeal or modify any statute or rule of law that is or would apply to corporation organized under the [Model] Business Corporation Act . . . and that does not elect to become a statutory close corporation . . . ." Even if other close corporation statutes do not explicitly include such negative implication the same rule applies.

Courts of equity basically recognized the necessity to grant dissolution in two types of situations 1) the corporation could not be operated any more (obviously, deadlock is aimed at here) 2) oppression. In fact the equitable grounds for dissolution are not really important since courts rarely order dissolution in equity. The enactment of dissolution provision has made a discussion of equity dissolution obsolete. What is important in reality is the willingness of court to order statutory judicial dissolution.

B. Courts fading reluctance to order (statutory) dissolution

When do courts order dissolution and which facts lead to such decision can only be inferred from a casuistic study. Dissolution cases have lead to different statistical studies (see infra. V.C.3.). We cite some of the more recent cases.

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335 Model Stat. Close Corp. Supp. § 3(a)
336 Bahls, supra note 194 at 315
337 Bahls, supra note 194 at 295
338 Shapiro, supra note 316 at 1126
Re Kemp & Beatty, Inc.\textsuperscript{339}, is a dissolution with alternative buy out case. As previously mentioned it is one of the leading “oppression cases”. Denial of return of investment was found to be “oppressive” enough to justify dissolution. Lowder v. All Star Mills, Inc.\textsuperscript{340} is a case where the court used the reasonable expectations standard to grant dissolution. The court considered that dissolution was the only way to fulfill the reasonable expectations of the minority. In Matter of Schwen\textsuperscript{341} the court introduced a two part test to grant dissolution. First the showing of oppressive conduct. Second dissolution must be the only feasible measure of fairly compensating the minority shareholder. Dissolution was denied. In re Harris\textsuperscript{342} the court also considered dissolution as a last resort solution to provide to the shareholder a fair return on his investment. The court added that liquidation must be reasonably necessary to protect interest of most of the shareholders. Dissolution would be denied if a fair return could be guaranteed by a forced buy out. Giannoti v. Hamway\textsuperscript{343} is also one of these leading oppression case in which the court found dissolution legitimate because the majority failed to pay adequate dividends and engaged in a freeze out scheme of conduct. In Ropper v. Dynamique Concepts, Inc.\textsuperscript{344} the court confirmed that a good faith justification for corporate actions will overcome oppression. Dissolution was denied.

Even though dissolution is available in most states for closely as well as publicly held corporation. Judicial dissolution is in reality only available to close corporations. Courts almost never dissolve public corporations\textsuperscript{345}.

\textsuperscript{339} 473 N.E.2d 1173 (N.Y. 1984)
\textsuperscript{340} 75 N.C. App. 233, 330 S.E.2d 649 (1985)
\textsuperscript{341} 199 N.L.Y.J. 26 (Sup. Ct. 1988)
\textsuperscript{342} 500 N.Y.S.2d 5 (1986)
\textsuperscript{343} 387 S.E.2D 725 (Va. 1990).
\textsuperscript{344} 447 S.E.2d 218 (Ct. App. 1994)
\textsuperscript{345} O’NEAL’S. CLOSE CORPORATIONS, supra note 2 at §1.16
Courts' general reluctance to order dissolution (in close corporations) leads to legally weak results. Some courts have held that oppressive conduct occurred and nevertheless refused to grant statutory dissolution. Others needed accumulation of oppressive acts to warrant dissolution.

Dissolution seems to have been ordered by courts for the same grounds as dissolution based on equity: 1) deadlock 2) egregious conduct by dominant group. But even courts using the reasonable expectation standard appear to work on a case by case basis to determine if the conduct complained is egregious enough and unfair to warrant relief. So despite the development of standards, decisions are still taken on a case by case basis. Other dissolution cases had for grounds “wilfully unfair” and “unfairly prejudicial” conduct or “abuse of authority.” On the other hand courts are unwilling to grant relief (not only dissolution) for mere policy disagreement not resulting in deadlock or transitory grievance. Court were reluctant to order dissolution. They still are but slowly the attitude is changing. In recent years court have ordered more dissolutions. Courts still seem to be more hesitant to grant dissolution when the firm is profitable even when the majority allocates the profits to themselves. The McAllister case mentioned above speaks for himself.

The parallel evolution of the broadening of the interpretation of “oppression”, the acceptance of dissolution and the creation of alternative remedies brought courts to justify

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346 Shapiro, supra note 316 at 1137 (Citing Alaska Plastics Inc. v. Coppock, 621 P.2d 270 (Alaska 1980))
347 Id. (Citing Fix v. Fix Material Co., 538 S.W.2d 351 (Mo. Ct. App. 1976))
348 Haynsworth, supra note 316 at 56
350 Shapiro, supra note 316 at 1144-1146
351 Haynsworth, supra note 316 at 75, 86
352 Ferdinand S. Timio, Annotation, What amounts to “oppressive” conduct under statute authorizing dissolution of corporation at suit of minority stockholders, 56 A.L.R. 3d 358 (Suppl. 1996) (for a discussion of all recent cases where dissolution was granted or denied)
353 O'Neill supra note 17 at 646
dissolution only for severely oppressive conduct while for less oppressive conduct, less drastic (alternative) remedies are required\textsuperscript{354}. For the minority shareholder what matters is, that if needed, in last resort, dissolution will be granted. There is a way out of the close corporation, although it is costly and time consuming.

C. Evaluation of the dissolution remedy

1. Arguments in favor

Dissolution has many advantages. The shareholder is allowed to recover his investment when he is frozen-out. No investment is perpetual. The threat of dissolution has a preventive aspect. It deters oppressive conduct from the majority\textsuperscript{355}. Dissolution is also needed because "the little people" of close corporation do not contract adequately. The law must provide a way out although the same, if not better, results could be obtained through private contracting. In a sense the law plays the role of "consumer protection" for unsophisticated investors. Furthermore the risks of abuse are benign. Minority shareholders rarely use the remedy just to withdraw their capital without sufficient reasons. Judges are cautious not to interfere in mere corporate policy disputes\textsuperscript{356}. But some commentators are still not reassured. They point out that most dissolution statute do not request possession of a minimum amount of shares to sue. A shareholder owning one

\textsuperscript{354} Murdock, supra note 31 at 427

\textsuperscript{355} Brownlee, supra note 320 at 283 (citing Marilyn B. Cane, Oppressive Conduct: Should it be grounds for judicial dissolution?, The Q. Rep. (The Fla. Bar Business Law Section, Tallahassee, Fla.), Dec. 1993, at 20-21) but the author himself does not believe dissolution has a preventive effect. at 269; O’NEAL’S. OPPRESSION, supra note 104 at §10:09

\textsuperscript{356} Thompson, Shareholder’s Cause, supra note 24 at 715
share can theoretically petition for dissolution\textsuperscript{357}. The majority could also abuse the remedy by threatening the minority with a dissolution to force a buy-out\textsuperscript{358}. It is doubtful that courts will be mislead in such eventuality. However it cannot be denied that the remedy tips/ redresses the balance of power to minority shareholders\textsuperscript{359}. The majority, faced with potential adverse consequences of dissolution, like for instance fiscal consequences, can feel compelled to settle with the plaintiff on terms that are objectively too favorable for the minority\textsuperscript{360}.

Partners can dissolve and withdraw from partnerships at will. The promoters of the dissolution remedy in corporation draw the parallel. The legal framework, however is different. In a partnership, the withdrawing partner is liable for the damages caused by its action\textsuperscript{361}. A withdrawing partners ("only") risk is that he will loose his interest in the name of the goodwill of the business and based on this be liable for damages inflicted\textsuperscript{362}. The partnership analogy has been invoked to promote dissolution at will of close corporations\textsuperscript{363}. When dissolution at will is available then the business judgment rule can be applied fully without risks of oppression. Dissolution at will can be highly abused and lead to strategic withdrawal. For instance excluding co-ventures with a buy back operation when the prospects of business rentability are improving. On the other hand dissolution at will deters absolutely oppressive behavior and induces cooperation\textsuperscript{364}. However this would totally destroy the stability and relative permanence of close

\textsuperscript{357} Brownlee, supra note 320 at 291
\textsuperscript{358} Id. at 291
\textsuperscript{359} Bahls, supra note 194 at 296; Model Stat. Close Corp. Supp. § 40 (official comment, acknowledging that the remedy gives much power to the minority)
\textsuperscript{360} Haynsworth, supra note 316 at 90
\textsuperscript{361} Shapiro , supra 316 note at 1121-1222
\textsuperscript{362} Israels, Sacred cow, supra note 18 at 789
\textsuperscript{363} O'Neill supra note 17 at 690
\textsuperscript{364} Id. at 702
corporations, one of the important features of corporations. Corporations are not partnerships.

2. Arguments tending to be in disfavor of the dissolution remedy

An old fashioned argument against dissolution states that courts should not dissolve legislative creations. In fact this dates back to the early reluctance of courts to grant dissolution in equity because the sovereign act of the state (king or legislature) created the corporation and this sovereign act should be respected. A rule abrogated by the courts in 1892. With the enactment of dissolution statute it is not permissible anymore to doubt that dissolution power has been granted to the courts.

Another argument used by the opponents of dissolution is the vagueness of the standard used to define oppression. But this does not jeopardize the remedy as such. Moreover the reasonable expectation standard is invoked by the same opponents who criticize the vagueness of the criteria. They contend that dissolution does not fulfill the reasonable expectations of the majority. This argument misinterprets reasonable expectations. A criterium that takes the expectations of all parties into account.

An undeniable drawback of the remedy is that it is costly and time consuming. The economic cost has two aspect. First the procedure itself is costly. Legal cost associated with dissolution are so high that they do not compensate for the costs of hiring a competent lawyer to draft and provide for adequate protection. Second and more important dissolution often results in loss of going concern value. An important

365 Bahls, supra note 194 at 294-295; Miner v. Belle Isle Ice Co., 93 Mich. 97, 53 N.W. 218 (1892)
366 Shapiro, supra 316 note at 1148
367 Bahls, supra note 194 at 296
368 O’NEAL’S, OPPRESSION, supra note 104 at § 9.03-9
consideration for the minority shareholders before requesting dissolution is the loss that has already occurred due to the mismanagement. It is often wiser to stay locked in because the actual value of the business has already dropped tremendously. In theory, the better solution is the replacement of the management team. Since there is no market for corporate control of close corporations, it is unlikely that this will happen. Thus the threat of dissolution is useful because it allows minority to obtain a buy out. Buy out functions as ersatz for the absent securities market. (See infra. VI.A. buy-out and especially VI.A.5. valuation). Buy out can make it possible to avoid loss of going concern value, depending on the judicially imposed fair value or on the price that has been bargained for by the parties. In any case the situation is worse if the corporation is dissolved judicially and liquidated. Certainly, if at the auction the majority shareholder is the only buyer. Then an artificially low bid can be expected.

Another weak argument states that judicial efficiency is decreased with dissolution cases. Courts have to spend valuable resources to determine oppressive conduct, interfere in business judgment, and bring to a good end long and difficult dissolution proceedings. Therefore some argue dissolution should not be made available.

The price for the society is also not negligible. Job loss for employees in case of liquidation, loss for suppliers and eventually for the market as a whole if consequently the price of the produced consumer good raises. But public policy also demands minority protection, to encourage investment in growth and new businesses. Businesses who create

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370 Brownlee, supra note 320 at 290
371 Hetherington, Illiquidity, supra note 29 at 28 (but concluding that buy out is a very likely outcome of dissolution because parties have more to gain from a buy out in almost any eventuality)
372 Brownlee, supra note 320 at 294
373 Id. at 289; Bahls, supra note 194 at 296-297 ("the undefined harm to the public")
new jobs, goods and opportunities. The economy has everything to lose from dead, locked-in capital.

Opponents naturally blame that dissolution disrespects the business judgment rule. A rule, however, whose strict application in the close corporation context is not desired (supra. III ?? bjr). The majority rule is naturally also invoked. The assumption of the majority rule is that minority shareholders implicitly surrender control for their investment. The potential unfairness to majority shareholders of dissolution cannot totally be overlooked they are deprived of their inherent control rights.

Hillman states that the concept that close corporation should be dissolvable (at will) rests on questionable assumptions. The myth of painless buy-out, neglects the difficulties of such financial operation. New capital must be attracted presumably from outsiders or the majority is forced to invest greater resources than what it planned. Another assumption is that protection of the minority is more important than corporate permanence. However it is permanence that gives corporation the ability to attract financing or equity investors.

3. A drastic remedy? The erroneous liquidation assumption

Courts consider dissolution to be a drastic remedy, "a judicially imposed death".

Although successive laws have tried to promote dissolution, those same laws never

374 Shapiro, supra 316 note at 1151
375 Brownlee, supra note 320 at 293
376 Shapiro, supra note 316 note at 1149
377 Haynsworth, supra note 316 at 31
378 Hillman, supra note 136 at 69-71
379 Id. at 74
380 Murdock, supra note 31 at 426, 441 (Murdock gives two reasons for such qualification 1) respect for legal entity created by legislature 2) confusion of dissolution and liquidation; Hetherington, Illiquidity, supra note 29 at 26
abandoned the same attitude of distrust of the remedy. The distrust of dissolution is grounded in the assumption that liquidation is an unavoidable consequence of dissolution. When courts order dissolution they will appoint a "receiver" to wind up and liquidate the business. It is true that liquidation can have dramatic consequences for the value of a going concern business. If a receiver appointed by the court sells the business in an auction sale, typically a fire sale, the chances are high that the business will not yield maximum value. Certainly if the business is sold in separate entities. Moreover many potential investors are excluded since these kind of sales require payment of purchase price immediately or in a brief period of time. Finally, like in many sales sellers good-will is lost. Specifically, the good relationship with customers and suppliers. All these considerations boost courts reluctance to grant dissolution.

The assumption that dissolutions result in liquidation is fallacious. Two statistical study show that the contrary is true. In Hetherington and Dooley's study not one viable business was liquidated. In most cases one party bought the other out. The business was eventually sold as a going concern to a third party. Buy out seems in fact to be the naturally arising solution. Interesting is that the few businesses where liquidation occurred, the businesses were continued or partially continued after liquidation.

Haynsworth reaches a few years later the same conclusion. Buy-out when available is most frequently ordered by the courts. The buy out remedy was in the mean time made more largely available by statutes. In 27% of the cases dissolution was ordered. In fact

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381 Model Stat. Close Corp. Supp. § 40 (official comment, qualifying dissolution as a last resort, drastic remedy)
382 Model Bus. Corp. Act § 14.32
383 Bahls, supra note 194 at 297
384 Id.
385 O'Neil supra note 17 at 693
386 Bahls, supra note 194 at 297; Shapiro, supra 316 note at 1150
387 Hetherington, Illiquidity, supra note 29 at 27, 30-34
388 Id. at 32-33
buy out cases in Haynsworth study seem to match the same percentages as dissolution cases that resulted in buy outs in Hetherington’s study. Liquidation only occurs if both party wish that result. Otherwise a negotiated solution will arise. In fact if a business is viable it will be continued, if not it will be terminated, irrespective of judicial intervention. Dissolution influences the condition under which a business is to be continued not its existence.

Thus, dissolution appears not to be a solution on itself but a first step towards a (negotiated or forced) buy out. The business is continued but a transaction cost for withdrawal is paid. Buy out equals replacement of capital. It is likely that the new capital will come at a higher cost than the capital of the departing shareholder. Evaluation of the dissolution remedy is thus incomplete without an evaluation of the buy-out alternative and the reasons for its increasing popularity. (. VI.)

In the mean time it can be stated that dissolution is sometimes an absolute necessity, be it in last resort.

D. A needed relief

Authors’ plead for dissolution has a long history. Carlos D. Israels lead the way in 1952 by questioning the principle of corporate permanence in a famous article. Nowadays, most court behave more sympathetically towards dissolution. This suits have increased success because they allow to gain satisfactory results for oppressed minority

389 Haynsworth, supra note 316 at 53-55
390 Hetherington, Illiquidity, supra note 29 at 27
391 Murdock, supra note 31 at 446
392 Thompson’s, dissolution, supra note 23 at 223
393 See generally, Israels, Sacred cow, supra note 18 (“corporate contract is not a holy sacrament”)
shareholders\textsuperscript{394}. Moreover broad standards such as reasonable expectations support courts in ordering dissolution or other reliefs\textsuperscript{395}.

The availability of involuntary dissolution must be supported because at one point in time it is needed. Dissolution is needed in two ways, as a final solution and more often as part of negotiations.

Dissolution is needed as a final solution when shareholders tensions in close corporation due to deadlock or oppression make them ineffective. Close corporations are fragile entities working primarily on the close relationships between the participants. Deadlock or other unsolvable tensions in close corporation are socially completely undesirable\textsuperscript{396}. Dissolution seems then the only adequate remedy because there is no other way out\textsuperscript{397}. And although the majority has a right to trust that the investment of the minority will bear the same risks as theirs this right must be limited. The majority has some inherent rights of control of their investment and that of the minority. However those rights do not go so far as the right to frustrate reasonable expectations of entrusted investment. Receiving rights over other persons investments goes along with the duty to respect the reasons that induced these investments. The risk of frustrated expectations is laid upon the whole corporation, majority and minority. For the majority this is translated by the right of the minority to withdraw. For the minority, the risk is translated by a right to withdraw in limited circumstances. Only when the majority has frustrated reasonable expectations.

\textsuperscript{394} Arthur D. Spratlin, Jr., Modern remedies for oppression in the closely held corporation, 60 Miss. L.J. 405, 417-418 (1990)
\textsuperscript{395} O’Neal's, Close Corporations. supra note 2 at §9.29
\textsuperscript{396} Israels, Sacred cow, supra note 18 at 789
\textsuperscript{397} Hetherington, Illiquidity, supra note 29 at 7
In the sense that dissolution provides a way out, a definitive solution when conflicts cannot be resolved amicably anymore, dissolution is an effective method\textsuperscript{398}. A relative effectiveness because sometimes it is better to stay locked in and frozen out\textsuperscript{399}.

Since dissolution provides a way out, one must wonder if there are not less drastic methods to provide for an exit. Here dissolution is used as leverage in negotiations. It is important to understand why dissolution suits are filed. Dissolution is not a final goal but just a mean to achieve other ends. A shareholder sues for dissolution because 1) he wants to withdraw his investment 2) he wants other shareholders to withdraw 3) he wants to influence corporate policy\textsuperscript{400}. Dissolution is needed for the negotiation process because it is unrealistic to think that majority will offer a fair price if not forced too\textsuperscript{401}. The majority has no reasons to buy extra shares. They do not need them. Petitioner is does able to achieve his goal without that dissolution is needed as result. Dissolution suits do not affect the existence of the firm but push negotiation forward in a given direction\textsuperscript{402}. Dissolution has does outgrown its original goal and has become a general remedy for dissension\textsuperscript{403}. The question becomes now how badly dissolution is needed and in which situations?

Some states have introduced limitations of the right to request dissolution. New York for instance requires a 20% share ownership to request the dissolution of a close corporation\textsuperscript{404}. A minimum percentage of ownership requirement can be found in several

\textsuperscript{398} Haynsworth, supra note 316 at 85; O’NEAL’S, OPPRESSION, supra note 104 at §7:21 (“Suits for dissolution seems to have had considerable success in achieving satisfactory settlements for minority shareholders”)  
\textsuperscript{399} Brownlee, supra note 320 at 269, 283-295 (dissolution is not effective); Murdock, supra note 31 at 447  
\textsuperscript{400} Hetherington, Illiquidity, supra note 29 at 27  
\textsuperscript{401} Murdock, supra note 31 at 427  
\textsuperscript{402} Hetherington, Illiquidity, supra note 29 at 27, 30  
\textsuperscript{403} Thompson, Shareholder’s Cause, supra note 24 at 708  
\textsuperscript{404} N.Y. Bus. Corp L. § 1104(a)
other statutes. The argument for such limitation is not convincing. Why should it make a difference what percentage of shares is owned? These provision tend to give an incentive for oppression of unimportant participants. Once a problem arise, deadlock or oppression, all interests, however small, are endangered. A remedy is needed whatever the percentage of ownership. In fact the opposite is more logical. When minorities interest are important the burden on the majority to finance a buy out is bigger. Withdrawal of important percentages of ownership results in tremendous instability for the corporation. Courts, irrationally, (because they see dissolution as drastic), seem to be more willing to grant the relief when the requesting shareholder has an important interest in the firm.

Supporters of the dissolution remedy suggest that it should be mandatory instead of discretionary to overcome the reluctance of courts to use the remedy. Dissolution should become mandatory once the grounds have been established. The wordings “may dissolve”, giving discretionary powers to the courts should be amended. This however would make the statutes inflexible. Flexibility of remedies in the oppression of minority context is essential. The imagination of oppressing majorities, the diversity of squeeze out techniques must be countered by adaptable remedies. In fact one can expect the adverse effect. As we said courts have ordered more dissolution when alternative remedies and broader grounds and standard for dissolution developed. Without discretionary power to choose the appropriate remedy courts will revers the existing trend, narrow the

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405 Connecticut 10%, Louisiana 20% and a 6 month ownership, Massachusetts 40 %, Ohio 50 %, . . .
406 Haynsworth, supra note 316 at 40
407 Israels, Sacred cow, supra note 18 at 790
408 Murdock, supra note 31 at 443-444
409 ld. at 444-445
410 Shapiro, supra note 316 at 1153
411 Model Bus. Corp. Act § 14.30 (official comment) (emphasizing the discretionary power of the court)
interpretation of the grounds for dissolution and refuse to be forced to order a remedy they do not fully trust.

Finally, it can be discussed if dissolution should be a primary or a last resort remedy. A primary relief because it is not a final goal, and it helps to direct parties negotiation in one direction. This is unreasonable if the use of less definitive reliefs is possible. Why then not encourage courts to use them. Dissolution as a last resort remedy encourages court to grant alternative reliefs in situations where the facts do not justify dissolution but same some kind of intervention is necessary.\textsuperscript{412}

We pointed out that dissolution is intimately linked with buy out. Most statutes allow a Buy out of the shares of the party requesting dissolution. Buy out can simply be the result of negotiations influenced by a dissolution suit. And finally court can impose a forced buy out instead of dissolution. Dissolution quite systemically results in buy out. The effectiveness of the dissolution remedy can thus only be evaluated together with the buy out remedy and the resulting buy out price.

Dissolution cannot be imposed by courts without leaving to the majority shareholders an option to buy the minority out.\textsuperscript{413} It seems that to force dissolution without a chance of buy out is unfair for the majority and not beneficial to the minority. Dissolution is there to help liquidity not liquidation, therefore shareholders right to cause dissolution should be circumscribed by the right of the majority to purchase plaintiffs' shares at a fair price.\textsuperscript{414} A possible question is if dissolution is needed as a step before buy out or if the buy out remedy can be imposed absent dissolution. A question that will be addressed (infra. VI.A.2.)

\textsuperscript{412} Haynsworth, supra note 316 at 89

\textsuperscript{413} See also, Hetherington, Illiquidity, supra note 29 at 34

\textsuperscript{414} Rodman Elfin, A critique of the proposed statutory close corporation supplement to the model business corporation act, 8 J. Corp L. 439, 451 (1983)
The acceptance of dissolution as a valid remedy is influenced by the need to balance different objectives. The judge must balance between the expectations of minority shareholders and the voting and management rights of the majority.\(^{415}\) In more general terms dissolution rest on the belief that the interest of the minority are more important than the interest society has in the permanence of corporations.\(^{416}\)

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\(^{415}\) Haynsworth, *supra* note 316 at 26

\(^{416}\) Henderson, *supra* note 349 at 206; Brownlee, *supra* note 320 at 285
Chapter VI. Buy out and other alternatives

A. Forced buy out

1. "Voluntary" buy out

Buy out in a court proceedings occurs in two type of situations. In the first, and our primary concern, buy out is directly requested by the plaintiff to withdraw his interest. In the second case a motion for buy out is filed after plaintiff sought dissolution. Buy out here is not directly requested by the plaintiff but "voluntarily" by the defendant to avoid dissolution. We discuss "voluntary buy out" briefly.

Several states gave all corporations or majority shareholders the right to petition for a buy out when dissolution is requested\(^{417}\). Under these statutes once petition to purchase is filed the dissolution proceeding is stayed\(^ {418}\). Other states, like New Jersey, do not explicitly link voluntary buy out to dissolution but a shareholder may move to buy out in any court proceeding\(^ {419}\).

\(^{417}\) For instance, California, New Jersey, Rhode Island, West Virginia; The states following the MBCA see Model Bus. Corp. Act § 14.34 (as amended in 1991); E.g. Illinois, New York, Maryland and Wisconsin only for close corporations

\(^{418}\) Haynsworth, supra note 316 at 49

\(^{419}\) N.J. Stat. Ann. § 14A:12-7(8)
Although under this provisions a shareholder cannot request to be bought out, the court in *Brenner v. Berkowitz*\(^\text{420}\) indirectly recognized its inherent power to order a buy out.

The advantages of voluntary buy out are that dissolution is avoided and that shareholders can prevent airing of internal corporate dissension in the courts\(^\text{421}\). The official comment notes that the section was introduced to avoid strategic abuse of dissolution proceedings\(^\text{422}\). Most states do not give courts the discretion to reject a petition to buy out. This could be useful if a lesser remedy or buy out by the plaintiff would be more appropriate\(^\text{423}\).

2. Forced buy out: independent from dissolution?

Buy out and dissolution are both extraordinary reliefs\(^\text{424}\). Even though buy out is less drastic than dissolution it is still a drastic remedy. The bought out shareholder is eliminated from the corporation. If he did not wish that result he will certainly consider the remedy to be radical\(^\text{425}\).

The “supplement” therefore specifies that since dissolution is the ultimate remedy the buy out solution must always be evaluated before\(^\text{426}\). This is the so called “tiering of remedies” whereby ordinary reliefs (see infra VI.B.1.) have to be considered before buy out and buy out before dissolution.

The grounds to request dissolution, buy outs and ordinary reliefs are identical. This begs the question if the level of oppression must be the same for the less drastic buy out.

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\(^{421}\) Haynsworth, *supra* note 316 at 49


\(^{423}\) Haynsworth, *supra* note 316 at 49-50

\(^{424}\) Model Stat. Close Corp. Supp. § 42, 43

\(^{425}\) Id. at § 42 (official comment)(“A court ordered buy out is a drastic remedy”)

\(^{426}\) Id.
than for the last resort dissolution remedy? That buy out is considered less drastic than dissolution does not mandate the definition of standards to determine different degrees of egregious conduct. Rather, judges’ discretion should be respected. Differences in necessary level of oppression are not dictated by the difference between dissolution and buy out. Both in fact are very similar extraordinary, drastic reliefs. The question of level of oppression is more appropriate for ordinary reliefs. In any case the guide for the appropriate remedy remains its social effectiveness not the level of oppression. (see infra. VI.B.1. & VI.B.3.) It is however true that courts take the amount of oppression into account when they choose a remedy.

The precedent chapter concluded that dissolution cannot be ordered without giving an opportunity to the majority to propose a buy out. The contrary however is not true. Buy out as an independent remedy allows the oppressed shareholder to receive a value for his shares that he could impossibly receive in a liquidation proceeding. Buy out has a function as a way out of deadlock and as a punishment for oppressive conduct. The buy out remedy therefore must also develop as a solution independent from dissolution. According to the “supplement” buy out can always be avoided by unwilling shareholders. Instead they can allow the corporation to be dissolved. The designated purchasers will prefer dissolution if the economic prospects of the business are bleak. The idea is that it is unfair to impose a buy out without giving the purchaser an opportunity to dissolve. This right, however, negates the punitive function of the buy out remedy and is thus questionable. The right of the majority to still pursue dissolution, and thus pay liquidation value, should be left to the discretion of the court.

It is nonetheless true that buy out developed as an independent remedy out of the perception that dissolution proceedings are a costly and unnecessary first step towards

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427 Miller, supra note 162 at 245-247 (pleading for a more liberal approach of the interpretation of oppression for remedies less drastic than dissolution)

428 Id. at § 42 (b) (5) (d) and (official comment)
buy out. A direct right to request buy out has the advantage to eliminate the use of dissolution motions as tactical weapons in a buy out negotiation.

3. The legal recognition of the buy out remedy.

The first enacted buy out remedies took the form of an alternative to dissolution. A party could not move to be bought out but only to buy the other party out. Following the example of section 210 of the English Companies Act of 1948 four other states enacted buy out as an alternative to dissolution. In the last years many states have enacted buy out as an alternative to dissolution. Recent legislation authorize buy out separately from dissolution, often only for close corporations. Most general corporate dissolution statute do no provide for any other remedy than dissolution. The only alternative remedy in the MBCA is since 1991 the right to buy out the shares of party petitioning for dissolution.

Courts have held that buy out like other alternative reliefs can be granted on equitable grounds. In Stefano v. Coppock, Davis v. Sheerin, and Balvik v. Sylvester the courts held a buy out appropriate in equity even though the remedy was

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429 Hetherington, Illiquidity, supra note 29 at 46
430 California, Connecticut, South Carolina and West Virginia; See Stuart L. Pachman, Corporation evenly divided: judicial remedies for equal shareholders, 24 Seton Hall L. Rev. 234 (1993) (for a brief history of buy out)
431 Arizona (for close corporations), Illinois, Maine, Michigan (for unlisted shares), North Dakota (any equitable relief); Murdock, supra note 31 at 462. Only for close corporations and following the supplement are: e.g. Georgia, Montana, South Carolina, Wisconsin
432 Henderson, supra note 349 at 214; But remedies such as provisional directors and custodians are increasingly enacted, although rarely used
434 Henderson, supra note 349 at 214
435 705 P.2d 443 (Alaska 1985)
436 754 S.W.2d 375 (Tex App. Houston 1988)
437 411 N. W.2d 383 (N. D. 1987)
not available in the respective statutes. These courts argue that dissolution statutes are remedial, and that therefore they can certainly grant less drastic remedies. Virginia courts have defended a contrary view of exclusivity of statutory relief. They are in the minority. Buy out enjoys an increasing popularity. Besides cases ordering buy out in equity many are now ordered based on statutory provisions.

In re Wiedy's Furniture Clearance Center Co., Inc., the majority was forced to buy the shares of the minority even though buy out had not been requested. Oppressive conduct of the majority had frustrated reasonable expectations of the plaintiff. The buy out price ordered was higher than the liquidation price. A very flexible order was issued in Gimpel v. Bolstein where the court ordered that the shareholder elect or to commence paying substantial dividends or to make a good faith purchase of the share of the minority. In re Kemp & Beatty, Inc. the corporation could choose between buy out and dissolution. The difference between the two cases can be explained by the more obvious oppressive conduct in Kemp & Beatty. In Orchard v. Covelli buy out was ordered at a price that had been offered to other investors. The court also ordered the payment of a prejudgment interest. Donahue v. Rodd Electrotype Co. is a case where buy out was ordered on a breach of fiduciary duty ground. Because the Minnesota court, in a criticized narrow statutory interpretation, refused to order a buy out the Minnesota statute was amended to emphasis the possibility of ordering buy out. The

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439 487 N.Y.S.2d 901 (N.Y. 1985)
440 477 N.Y.S.2d 1014, 1022 (N.Y. Sup. Court. 1984)
441 473 N.E.2d 1173 (N.Y. 1984)
442 Haynsworth, supra note 316 at 71
443 590 F. Supp. 1548 (W. D. Penn. 1984), aff'd, 802 F. 2d 448 (3rd Cir. 1986)
444 367 Mass. 578, 328 N.E.2d 505 (1975)
446 Minn. Stat. § 302A.751 subd 3b (effective August 1, 1986)
availability of the buy out remedy has been restricted by the same court via the availability of direct action. In *Skoglund v. Brady*[^47], a surprising decision of the Minnesota Court of Appeals it was declared that a direct cause of action for buy out will not be available if all shareholders have been harmed equally.

Courts are in general more willing than in the past to order buy out[^48]. They however still require serious misconduct as a precondition for relief[^49]. The recognition of buy out and the preference over dissolution is motivated by court’s impression that it is a less harsh remedy[^50].

4. Evaluation of the buy out remedy

Buy out has been qualified as the most prevalent relief[^51] and most popular alternative for dissolution[^52]. Haynsworth study shows that buy out is the most frequent relief ordered by courts or elected by defendants[^53]. Compared with an earlier study by Hetherington and Dooley[^54], negotiated buy out have been replaced by court ordered buy out. This is due to new legislative provisions and increasing willingness of courts to order the remedy[^55].

Buy out arise automatically as an alternative for dissolution in a healthy business. If one party wants to continue the business both have an interest to reach an agreement. The seller risks a depreciated price if the corporation is dissolved while the buyer risks to be

[^47]: 541 N.W. 2d 17 (Minn. App. 1996)
[^48]: Thompson, Shareholder’s Cause, supra note 24 at 720-721
[^49]: Haynsworth, supra note 316 at 86
[^50]: Thompson, Shareholder’s Cause, supra note 24 at 721-722
[^51]: Haynsworth, supra note 316 at 43
[^52]: Henderson, supra note 349 at 217
[^53]: Haynsworth, supra note 316 at 53
[^54]: Hetherington, Illiquidity, supra note 29 at 31
[^55]: Haynsworth, supra note 316 at 54 (See also supra. V.?? both studies are mentioned)
eliminated in an auction by a third party or to have to pay a control premium besides all the expenses caused by the dissolution proceeding\textsuperscript{456}. The single most important determinant of buy out is the success of the firm. Buy out occurs almost systematically in profitable firms plagued by dissension\textsuperscript{457}.

The remedy has some characteristics that plead for a wider application. Buy out is a definitive solution. Getting rid of dissension at a fair price is always satisfactory for the corporation and for the minority who is able to withdraw\textsuperscript{458}. As an alternative to dissolution buy out offers two theoretical advantage. The business is continued and no value is lost unnecessarily\textsuperscript{459}.

Hetherington and Dooley proposed buy out as exclusive remedy since dissolution just functions as price fixing mechanism\textsuperscript{460}. In fact dissolution and its alternatives “are costly and ineffectual and considerations of equity and efficiency justify permitting the minority to withdraw its investment for any reason”\textsuperscript{461}. They therefore plead for an unconditional buy out right. Moreover such remedy would reduce the necessity to draft complex buy out arrangements resulting in a decrease in transaction cost. The availability of buy out has an undeniable preventive function as disincentive for opportunistic conduct\textsuperscript{462}. But automatic buy out of the minority could frustrate reasonable expectations more than the oppression itself\textsuperscript{463}. Buy out is not always necessary that is why a whole set of alternative reliefs was developed over the time

\textsuperscript{456} Hetherington, Illiquidity, supra note 29 at 28
\textsuperscript{457} Id. at 33
\textsuperscript{458} Haynsworth, supra note 316 at 53
\textsuperscript{459} Bahls, supra note 194 at 298
\textsuperscript{460} Hetherington, Illiquidity, supra note 29 at 34; Adam Chernichaw, Note, Oppressed shareholders in close corporations: a market oriented statutory remedy, 16 Cardozo L. Rev. 501, 525-526 (1994) (proposing dissolution and buy out as only available relief)
\textsuperscript{461} Hetherington, Illiquidity, supra note 29 at 6
\textsuperscript{462} Id. at 47
\textsuperscript{463} Bahls, supra note 194 at 318
Buy out is certainly not a perfect solution. There are circumstances where it is better to stay locked in than bought out. It is the case when a shareholder expects to get liquidation value while going concern value is much higher. He then chooses to stay lock in under the assumption that in a near future his interest will be purchased at a higher value. Such decision depends much on the ratio of profitability to capital. To award a fair value for shareholder’s stock does not always compensate for the loss of expectation of participation in management.

An argument recurring for all proposed remedies is the risk of abuse by the minority to extort concessions. For buy out the fear is enhanced by the financial implications of the remedy. This abuse of minority argument, however, does not correspond with the picture provided by the numerous corporate dissension cases.

Easterbrook and Fischel point out that a buy out creates liquidity problems for the corporation. Hillman speaks of “the myth of painless buy out”. He reminds that the withdrawing capital has to be replaced at a usually higher cost. The transaction renders the corporation vulnerable and subject to the uncertainties of the credit market. The borrowing capacity of the corporation is highly reduced. Eventually a new stockholder has to be attracted. An investor that could request significant concessions from the majority. Hillman disagrees that a shareholder should have the right to inflict such strain on his co-venturers because the commitment to the close corporation is based on the idea of permanence. But if the difficulty in finding equity investors for close corporations is caused by the “lock-in effect” the availability of a buy out remedy might

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464 Murdock, supra note 31 at 447-450
465 Bahls, supra note 194 at 299
466 Hetherington, Illiquidity, supra note 29 at 49
467 Easterbrook, Agency cost, supra note 5 at 289-290;
468 Hillman, supra note 136 at 70-72
469 Id. at 72-73
in fact facilitate investment in close corporations. Moreover as leveraged buy outs have demonstrated in the latest years when a business is profitable acquisition can be financed. Rationally courts should be less reluctant to order buy out when the minority has only a small interest in the corporation. (Infra VI.A.4.b.(iii) Installment)

Finally, valuation is a difficult and expensive process. The cost of buy out includes procedural and transaction cost of negotiating an agreement to mitigate the impact of a perceived unsatisfactory court decree. The cost of the remedy makes it often at least an unpractical if not unavailable remedy.

Despite undeniable drawbacks it is clear that the development of the buy out remedy deeply changes the posture of minority shareholders. They are no longer helpless. They are able to withdraw under economical reasonable conditions when the majority acts oppressively. This right has been wisely disconnected in the last year from dissolution. An unduly burdensome and unnecessary step for a business that is to be continued. And a necessity to assure that the withdrawing shareholder will receive a “fair” going concern value. An improvement which price, a questioning of the traditional stabilityand permanence of corporations and of the immunity of the majority, is worth to pay.

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470 Hetherington, Illiquidity, supra note 29 at 50
471 Murdock, supra note 31 at 444
472 Id.
473 Bahls, supra note 194 at 336
474 Murdock, supra note 31 at 484-485
4. The terms of a buy out

a. Who is bought out?

Until recently courts always ordered the buy out of the minority by the majority. The rationale behind it is that the majority, as the main owner, has more rights to stay in the business than the minority. Moreover, in most cases it is only the majority who has the necessary financial strength to pay for a buy out and the capability to operate a going concern business. In 1996 the New Jersey Supreme Court in *Mullenberg v. Bikon Corp.*, opened the way for buy out by the minority. The unanimous court held that in exceptional cases courts may force the majority shareholders of a close corporation to sell their shares. The court found that the majority was perfectly able to remain in the American market, compete with the corporation of the minority and thereby fulfill their original expectations. The minority was also found to have sufficient funds to consummate a stock purchase. The decision was further supported by the clear oppressive conduct of the majority and by the fact that the minority managed for years the day to day operations of the company. A few English precedents had already recognized the possibility of forced buy out of the majority. Buy out by the minority is supported by Hetherington’s and Dooley’s study that showed that the minority sometimes purchases

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475 Bahls, *supra* note 194 at 299
477 *Id.* at 1389-90
478 Daniel A. Ippolito, Survey, *Corporate law- Closely held corporations- Courts may, in rate circumstances, order the buy out of majority shareholders of a closely-held corporation by oppressed minority shareholders.* 26 Seton Hall L. Rev. 1369 (1996) (for a discussion of the Mullenberg case)
479 Re Jermyn Street Turkish Baths, Ltd. [1970], 3 All E. R. 57, 1 W. L. R. 1042 (Ch.)
majority’s stock when parties negotiate a way out of dissension.\textsuperscript{480} Moreover, equity requires that the party with clean hands, the innocent minority is granted protection.\textsuperscript{481}

Courts ordering a buy out should take a number of factors into consideration to decide who will be forced to sell its shares:\textsuperscript{482}

1. The respective financial situation of the shareholders
2. The ability to restrain the selling shareholder from competing with the buying shareholder
3. The ability of the shareholders to operate the business profitably
4. The ability of the oppressive shareholder to pay damages for the loss he inflicted.

Under equal factors, there is no reason to give an advantage to the oppressive majority over the innocent minority.\textsuperscript{483} The same factors are used to decide which party should prevail in a 50%/50% deadlock. There are only few cases dealing with such situation.\textsuperscript{484}

b. Other terms

(i). The complexity of negotiated terms

Statutes in general should grant to the courts the necessary flexibility to include at discretion all provisions that lawyers would include in privately negotiated agreements.\textsuperscript{485} However, it must be kept in mind that terms of negotiated buy out can be awfully

\textsuperscript{480} Hetherington, Illiquidity, supra note 29 at 31 (3 cases out 54 involuntary dissolution cases)
\textsuperscript{481} Bahls, supra note 194 at 300
\textsuperscript{482} Id. at 299 (citing Hendley v. Lee 676 F. Supp. 1317, 1327 (D.S.C. 1987) (also considering which party would suffer less tax consequences)
\textsuperscript{483} Id. at 300
\textsuperscript{484} See generally Stuart L. Pachman, Corporation evenly divided: judicial remedies for equal shareholders, 24 Seton Hall L. Rev. 234, 250-252 (1993) (discussing the choice between equal shareholders)
\textsuperscript{485} Haynsworth, supra note 316 at 49
complex. Agreements will include: warranties, covenants not to compete, provisions addressing the fiscal consequences, installment payments and alternative remedies for default. Courts can impossibly master the complexity of such agreements. Therefore courts have the tendency to issue simple buy out orders ordering cash payment on the day the seller transfers the stock. But, some important terms should be specified by the courts. The “supplement” list a few terms that the court can specify if deemed appropriate. Among those, installment and agreement not to compete. The aim is to “minimize the financial strain on the purchasers”, although some financial disruption is inevitable.

Parties may usually petition the court later on to modify the terms of the purchase because “changes in the financial or legal ability of the corporation or other purchaser to complete the purchase justify modification”.

(ii). Agreement not to compete

Anti competition agreement should be required when the value of shareholders stock includes “good will”. Courts have in general been hesitant to restrict competition.

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486 Bahls, supra note 194 at 303
487 Id. at 304
488 Model Stat. Close Corp. Supp. § 42 (b) (2)- (5):
(b) (2) specify the terms of the purchase, including if appropriate terms for installment payments, subordination of the purchase obligation to the rights of the corporation’s other creditors, security for a deferred purchase price, and a covenant not to compete or other restriction on the seller;
(b) (3) require the seller to deliver all his shares to the purchaser upon receipt of the purchase price or the first installment of the purchase price;
(b) (4) provide that after the seller delivers his shares he has no further claim against the corporation, . . .
(b) (5) provide that if the purchase is not completed in accordance with the specified terms the corporation is to be dissolved . . .
489 Model Stat. Close Corp. Supp. § 42 (b) (2) (official comment)
490 Hillman, supra note 136 at 83
491 Model Stat. Close Corp. Supp. § 42 (c)
492 Bahls, supra note 194 at 304
and most statute are deficient on that point. The potential harm to the corporation of a competing shareholder can be terrible. Therefore, it is better when necessary to deal with the issue at the same time the buy out order is issued. Although complex, it is useful to leave to the courts the possibility to restrain competition if deemed necessary.

(iii). Installment

A few legislatures gave statutory power to their courts to order instalment. Other courts naturally may always use their equitable powers. Courts hesitate however because installment makes from the minority a creditor of the corporation. The minority assumes then the risk that the majority will siphon the assets of the corporation.

Structuring a buy out using installment payments minimizes a value decrease of the corporation. The borrowing ability of the corporation and its cash flow is not hit as hard. But courts are ill-equipped to tailor such installment to the need of both the corporation and its shareholders. Everybody would be better off if the parties negotiated a solution. The court can give an incentive by including a minority discount in the valuation of the shares. Buyer is than eager to negotiate an installment to avoid the costs of illiquidity while seller wishes to recuperate the value of the discount. Hillman argues that the burden of establishing the need for instalment and a reasonable appropriate period of time during which payments will occur should be on those who desire to continue the business. The danger is that these remaining participants might try later on to invoke either relevant statutory restrictions on distributions of funds to shareholder or financial

493 Haynsworth, supra note 316 at 48
494 e.g. Illinois, Maryland, Minnesota. But see California and New Jersey both requiring cash payments
495 Bahls, supra note 194 at 334
496 Id.
497 Id. at 336
hardship. In that case the withdrawing shareholder should be entitled to request dissolution for default in payment\textsuperscript{498}.

5. Valuation

a. Introduction

The importance of valuation is tremendous. The fairness and efficiency of buy out can only be evaluated correctly by judging the price at which the buy out is going to occur. The method of valuation will determine the size of the pay out which on his turn affects the ease for the purchaser of financing this payout\textsuperscript{499}.

Valuation is a quantifying process, that cannot always assure the shareholder that the purchase order will make them whole. Even if all quantitative elements would be correctly evaluated many subjective elements such as expectations cannot be included\textsuperscript{500}.

Only valuation at going concern value can meet the frustrated expectations of the oppressed shareholder. The corporation must then be valued as a whole and a percentage of ownership applied, not valuation of individual shares\textsuperscript{501}. The traditional proponents of corporate permanence argue the contrary. Hillman for instance deems “fair” that a shareholder should not receive more than the liquidation value. He reasons that since dissolution is the ultimate remedy a shareholder has no other expectations than to receive liquidation value. Moreover, he argues that because majority shareholders continue the

\textsuperscript{498} Hillman, \textit{supra} note 136 at 83
\textsuperscript{499} Murdock, \textit{supra} note 31 at 445, 471
\textsuperscript{500} Bahls, \textit{supra} note 194 at 300
\textsuperscript{501} Anthony, \textit{supra} note 510 at 1187
business after the buy out they should receive the entire going concern value\(^{502}\). The California statute for instance mandates a liquidation standard for buy out\(^{503}\).

Most statutes and cases however apply willing seller/willing buyer model as in dissenter’s right cases. This means valuation as a going concern rather than on a liquidation basis. Liquidation value usually results in enrichment of the majority and prejudice to the minority\(^{504}\).

Valuation is already a difficult exercise. In close corporations, the exercise flirts with the arbitrary. Uncertainty is even greater due to the lack of market and the lack of reliable financial information\(^{505}\). On top of that many appraisers are people who are attracted by the growth in this service industry and lack any serious qualification\(^{506}\).

The incredible complexity of valuation and the number of issues that must be considered tend to support the argument that valuation procedures and methods should be left to courts so as to adapt to the variations of every specific case\(^{507}\).

b. Fair value

Statute admonish courts to determine “fair value” for the shares that will be bought out\(^{508}\). “Fair value” is a vague undefined concept\(^{509}\). It is not equal to “fair market value”. “Fair value” implies statutory recognition of the inappropriateness of market value in the

\(^{502}\) Hillman, supra note 136 at 82

\(^{503}\) Cal. Corp. Code § 2000 (however it does not exclude going concern value totally)

\(^{504}\) Haynsworth, supra note 316 at 44

\(^{505}\) Bahls, supra note 194 at 301 (The management can also easily falsify financial information)

\(^{506}\) Id. at 300

\(^{507}\) Hetherington, Illiquidity, supra note 29 at 57

\(^{508}\) Model Stat. Close Corp. Supp. § 42 (a)

\(^{509}\) Thompson, Shareholder’s Cause, supra note 24 at 702 (fair value is a price reasonable under all circumstances); re Valuation of Common Stock of Libby, McNeil & Libby, 406 A.2d 54, 60 (Me. 1979) (Fair value is “more akin to an artistic composition than to a scientific process”)

close corporation context\textsuperscript{510}. While hypothetical market value is a positive concept, fair value is inherently normative\textsuperscript{511}. The school of law and economics led by Easterbrook and Fischel avoids normative analysis and defines fair value as market value. This approach negates the impact of the legal framework of close corporations, on share value\textsuperscript{512}.

The official comment of the “supplement” explicitly promotes the use of dissenter’s rights principles of valuation for buy out\textsuperscript{513}. The view is shared by several courts who do not think that the different nature of the two proceedings affect valuation analysis\textsuperscript{514}.

The statutory definition of “fair value” in dissenters rights contestation is not of real help because it remains vague\textsuperscript{515}. South Carolina ads to this definition “that the value of the shares is to be determined by techniques that are accepted generally in the financial community”\textsuperscript{516}.

\textsuperscript{510} Joseph W. Anthony & Karlyn Vegoe Boraas, Betrayed, belittled . . . but triumphant: claims in closely held corporations, 22 Wm. Mitchell L. Rev. 1173, 1186 (1996)

\textsuperscript{511} Zenichi Shishido, The fair value of minority stock in closely held corporations, 62 Fordham L. Rev. 65, 66 (1993) (the impressive analysis of fair value in this article is based on a normative concept)

\textsuperscript{512} Shishido, supra 511 note at 67

\textsuperscript{513} Model Stat. Close Corp. Supp. § 42 (official comment)(“Fair value is to be determined under principles developed in dissenters’ rights and other valuation cases”)


\textsuperscript{515} Model Bus. Corp. Act § 13.01 (3) (“ Fair value, with respect to a dissenter’s shares, means the value of the shares immediately before the effectuation of the corporate action to which the dissenter objects, excluding any appreciation or depreciation in anticipation of the corporate action unless exclusion would be inequitable”)

\textsuperscript{516} S.C. Code Ann. § 33-13-101(3)
c. The inclusion of normative factors in valuation?

Valuation theories are in general conservative. It can be explained by the fact that they are often tax driven. This attitude questions the ability of valuation methods to include subjective elements like “oppression” or employment\(^{517}\).

Should oppressive conduct also be taken into account when valuing the shares? Some statute indirectly refer to that possibility\(^ {518}\). This would however complicate more, an already complex valuation process. Oppressive behavior can always handled in a separate common law claim for damages\(^ {519}\). Courts have also refused to have valuation affected by the misconduct of the minority\(^ {520}\).

A decision where the money shareholders is ordered to buy out the work shareholders seems logical. But in the close corporations context jobs are often more valuable than capital. A more liberal approach to valuation should make it possible to value the lost of earnings due to buy out more accurately\(^ {521}\). Like for instance, in *Hendley v. Lee*\(^ {522}\) where a granted salary adjustment had a dramatic impact upon valuation.

d. The date of valuation

Some statute have set out a date of valuation, usually the day the suit was filed or because the action may depress the value of the shares, the day before the suit was filed\(^ {523}\).

\(^{517}\) Murdock, *supra* note 31 at 471-472

\(^{518}\) N.J. Stat. Ann. § 14a:12-7(8)(a)

\(^{519}\) Hetherington, *Illiquidity*, *supra* note 29 at 57

\(^{520}\) Pooley *v.* Mankato Iron & Metal, Inc. 513 N.W. 2d834 (Minn. Ct. App. 1994)

\(^{521}\) Murdock, *supra* note 31 at 472

\(^{522}\) 676 F. Supp. 1317 (D.S.C. 1987)

\(^{523}\) Minn. Stat. Ann. § 302A.751 subd 2; N.Y. Bus. Corp. Law § 1118
In *Hendley v. Lee* the court stated that generally the value of the shares should be determined as of the date of trial. However, in oppression cases the date of ouster seems to be more appropriate. But this criteria is not always helpful. Oppression often occurs slowly and over a long period of time so that it is difficult to determine a date of ouster. Certainly if no expulsion occurs.

Courts, that value stock at a date after wrongdoing can compensate for the depressed value in two ways. They can consider the amount of damages to be an asset of the company for purpose of appraisal. Alternatively, they can order, besides a share purchase based on "actual" value, a payment of damages based on diminution of value due to wrongdoing by the majority. The New Jersey statute gives the broadest authorization to the courts for determining date of valuation: "as of the date of commencement of the action or such earlier or later date deemed equitable by the court, plus or minus any adjustment deemed equitable by the court".

e. Methods of valuation

The court may appoint appraisers to value the corporation. It may rely on their opinion but not delegate the power to determine fair value. If courts do not appoint appraisers the suit develops rapidly in a battle of the experts.

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525 Henderson, *supra* note 349 at 219 n. 119
529 Anthony, *supra* note 510 at 1188
In early years Delaware courts developed the so called Delaware Block valuation method. The “fair value” standard cannot be limited to a single method of valuation. Three major factors must be considered 1) net asset value, that can be evaluated by appraisers. 2) the market value, who is especially difficult to determine in close corporation when the market is thin or not existent. Eventually based on the offer of a potential buyer. 3) the earnings of investment value of the dissenting stock. Generally the company average earnings in previous years multiplied by a multiplier. The earnings method can in given circumstances yield the highest valuation. A method Hillman fiercely opposes arguing that the withdrawing partner should not benefit any more from the corporate venture. The problem with earnings valuation is that in close corporations earnings are distorted by owner compensation. Data such as gross billing can provide an alternative. Each factor should then be weighted as to his relative importance for the value of the dissenting stock.

The Delaware Block however is to limited. It does not allow to make a difference between a growth-oriented and an income-based company. Nowadays, courts try to take “all relevant factors” into consideration. The recognition of the complexity of valuation factors has made his way through statutory enactments. The “supplement”, for instance, lists the following factors that courts should consider to determine the value of the shares:

“... among other relevant evidence the going concern value of the corporation, any agreement among shareholders fixing the price or specifying a formula for determining share value for any purpose, the recommendations

530 See e.g. Santee Oil v. Cox, 217 S.E.2d 789 (S.C. 1975) (discussing the Delaware block method)
531 Murdock, supra note 31 at 473
532 Hillman, supra note 136 at 82
533 Murdock, supra note 31 at 451
534 Anthony, supra note 510 at 1188
535 Del. Stat. § 262(h)
of appraisers (if any) appointed by the court, and any legal constraints on the corporation’s ability to purchase the shares.\footnote{536}

The reference to “techniques that are accepted generally in the financial community\footnote{537}” reflects this same pluralistic approach.

For Prof. Shishido, fair value consist of cash flow discounted value, “which is the result of allowing the majority to keep entrepreneurial rewards and giving all shareholders a share in the hidden cash flow.”\footnote{538} This results in a “best use” value method\footnote{539}.

The effect of a buy out agreement on valuation is not clear. If the situation giving rise to buy out is not covered by the buy out agreement. Then the agreement is merely non conclusive evidence. The contractual buy out price will be used if the agreement covers the circumstances unless the buy out price is inequitable\footnote{540}.

The cases do not provide for a uniform clear picture of methods of valuation. Courts have used in the post Delaware Block area various valuation techniques. Valuation based on multiples of gross revenue, adjustment of earlier price paid by those acquiring a majority interest and discounted cash flow\footnote{541}. Courts most commonly use for close corporations the investment value based on company’s earnings or on a variety of factors\footnote{542}. In Segall v. Shore\footnote{543} the court rejected the use of “liquidation appraisal”

\footnotetext{536}{Model Stat. Close Corp. Supp. § 42 (b) (1)}
\footnotetext{537}{S.C. Code Ann. § 33-13-101(3)}
\footnotetext{538}{Shishido, supra 511 note at 67. 104 (Entrepreneurial rewards: reasonable salary, synergistic effect (effect of the combination of a related second company the buyer already possess), expectations of enhancing the companies value. Hidden Cash Flow: retained earnings, hidden retained earnings (due to excessive depreciation, e.g., due to high salaries or loans to the majority), hidden dividends. When asset value is higher than cash flow value, excessive asset value should also be included (a corporation that should theoretically be dissolved but is not for non economical reasons)}
\footnotetext{539}{Id. at 110}
\footnotetext{540}{Haynsworth, supra note 316 at 45 (citing Minn. Stat. Ann. § 302A.751 subd. 2 explicitly recognizing the right of the courts to ignore the agreement if the terms specified “are unreasonable under all the circumstances of the case”)}
\footnotetext{541}{Murdock, supra note 31 at 473}
\footnotetext{542}{O’NEAL’S, CLOSE CORPORATIONS, supra note 2 at § 9.34}
\footnotetext{543}{236 S.E.2d 316 (S.C. 1977)}
whereby an amount equal to tax liability is deducted from the value of the stock because there is “no reason to presuppose liquidation”. The corporation must be valued as a going concern. In *Hendley v. Lee* a capitalization of earnings approach was used. The adjusted pretax income for the most current fiscal year was multiplied by an “earnings multiplier”.

f. Discounts

(i). In general

Discounts are reductions of the value of the stock due to his negative qualities. These discounts, when applied, reduce on average the purchase price of the shares by ten to twenty-five percent.

Some have opined that discounts should never be taken into account or at least not in the close corporation context. Similarly, it has been argued that discounts can properly be applied in a willing buyer-seller transaction but never for court ordered sales between insiders. One of the recurring argument is that allowing discounts in oppression cases is an incentive for oppression. Furthermore discounts frustrate the

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545 Adjusted pretax income is composed of the company pretax income + non functional compensation paid to each officer. The court accepted a earnings multiplier of 4.48. The multiplier was found by dividing the value of the company in a given year by the company’s adjusted pretax income in that year.
546 Henderson, *supra* note 349 at 224
547 Thompson’s, *dissolution, supra* note 23 at 234
548 Harry J. Haynsworth, *Valuation of Business Interests*, 33 Mercer L. Rev. 457, 489-490 (1982) [hereinafter Haynsworth, *Valuation*] (opining that as a general rule courts should not apply discounts for minority interests) (See also generally, for a thorough discussion of discounts): Murdock, *supra* note 31 at 472 (discounts are appropriate in a tax setting but absolutely not in a state court proceeding)
550 Henderson, *supra* note 349 at 227-230 (discussing discount cases where it appears that this argument is systematically invoked)
reasonable expectations of the minority.\textsuperscript{551} Finally, the increasing number of remedies for the minority guarantees a more realistic share valuation\textsuperscript{552}. Is then a per-se rule never to apply discounts unhealthy? Is it not necessary to differentiate between the expectations of original participants and investors who acquired participation later on and to value their interest with other factors?\textsuperscript{553}

The applicability of discounts is different in every jurisdiction\textsuperscript{554}. Courts, generally, do not apply discount with a few exception for the lack of marketability discount\textsuperscript{555}.

As a general rule discounts unnecessarily complicate valuations and depreciate minority interests thereby frustrating further on not well motivated basis their expectations.

(ii). Minority discount

Applies because the acquisition of a non-controlling interest is worth less. It does not change the repartition of power in the corporation\textsuperscript{556}. The discount is justified by the assumption that the minority should not be paid more than what they would receive in a transaction at arms-length\textsuperscript{557}. Most courts rejected the minority discounts for two reasons\textsuperscript{558}. First, because in close corporation the majority already controls the corporation so it is of no importance for control that it is forced to buy additional

\textsuperscript{551} Haynsworth, \textit{Valuation}, supra note 548 at 489-490

\textsuperscript{552} Murdock, supra note 31 at 482

\textsuperscript{553} Bahls, supra note 194 at 302

\textsuperscript{554} Henderson, \textit{supra} note 349 at 224

\textsuperscript{555} O’NEAL’S, CLOSE CORPORATIONS, \textit{supra} note 2 at § 9.34

\textsuperscript{556} Haynsworth, \textit{Valuation}, \textit{supra} note 548 at 492-493


\textsuperscript{558} But see McCauley v. Tom McCauley & Son, Inc., 724 P.2d 232 (N.M. Ct. App. 1986) (emphasizing courts discretion to fashion appropriate relief, rejecting the “oppression” argument and authorizing minority discount)
shares. Second, the minority would receive its full pro-rata share in a dissolution proceeding there is no reason why this should be different in a buy out. It has been suggested to differentiate between those who acquired share by subscription upon incorporation and those who acquired shares by transfer. In the later category a minority discount is justified because they most likely acquired the shares at a discounted price.

In parallel a control premium should not be paid by the minority to a majority who is forced to sell her shares.

(iii). Marketability discounts

Close corporations have no ready market for their shares and its stock is often subject to transfer restriction. This reality reduces the value of the stock. A few courts have accepted the marketability discount because, whether the majority or the minority acquires the shares, the discount reflects the lesser value of shares that cannot be freely traded. The assumption that all shareholder groups suffer from the lack of marketability identically is flawed. It is often easier to sell a majority participation, presumably with a control premium. Marketability discounts are also rejected with the same argument used for other discounts, namely, that it would be unfair to authorize a discount to a majority who has acted oppressively.

559 Henderson, supra note 349 at 226
560 Assuming that buy is an equivalent alternative to dissolution and not a less drastic remedy granted at a lower level of oppression
561 Bahls, supra note 194 at 302-303
562 Haynsworth, supra note 316 at 45
563 Henderson, supra note 349 at 224, 226
565 Bahls, supra note 194 at 303-304
(iv). Key man discount

A reduction of the value of the stock due to the departure of a significant executive. This discount has only been found appropriate "in cases where the executive has already left the company and the company is unable to find a suitable replacement."

(v). Other adjustments:

Reduced liquidity discount due to buy out. This discount functions as an incentive to negotiate an installment. (supra VI.A.4.b.(iii)).

Adjustment for damages are supported by the view that conduct is part of valuation. This can be replaced by a common law damage action. (supra VI.A.5.c.)

It is not clear if courts may award a prejudgment interest. Denial of prejudgment interest is quite prejudicial for the seller certainly if the price of the shares is determined a few years after the suit is filed. Court are reluctant to grant prejudgment interest. This attitude encourages delaying tactics form the defendant. Courts should be allowed to award interest from a date the court deem equitable. Moreover it is argued that court should be given the authority to impose expert fees and attorneys' fees for arbitrary, vexatious or bad faith litigation.

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567 Bahls, supra note 194 at 336
568 Hetherington, Illiquidity, supra note 29 at 57
569 Haynsworth, supra note 316 at 45-46
570 Id. at 47
(g) The illusion of predictability.

The withdrawing shareholder is fairly treated when he receives the real going concern value for his shares. Dead asset valuation is an incentive for oppressive conduct. Determining going concern value has proven to be a fairly artistic exercise. Shareholders however need certainty to evaluate the risks taken and the appropriateness of remedial actions. Here lies the unsolvable contradiction of valuation. Methods of valuation listing a limited amount of criteria have proven to be inaccurate and unfair. Methods trying to incorporate all relevant quantitative and normative elements, have not proven to be more effective. They do not provide for any certainty and flirt with the arbitrary. Judge’s discretion should be preserved so as to permit adaptability of valuations. References to appraisers, battle of experts and “techniques that are accepted generally in the financial community” while not providing illusive certainty, increase the predictability of going concern valuation.

B. Alternative remedies

1. Introduction

Alternative remedies sprang out of the willingness to grant relief for (minor) dissension. The perception that buy out and dissolution lead sometimes to economic waste, supported further the adoption of alternatives\(^{571}\). Statutes who provide alternatives to dissolution, like buy out or other ordinary reliefs increase the probability that a judge

\(^{571}\) Bahls, supra note 194 at 307
will effectively order a remedy for dissension. Although alternative remedies where enacted to promote relief including dissolution but one can also see in their enactment the distrust on legislative level of the dissolution remedy. Accordingly, some fear that it is probable that the presence of alternative remedies will increase courts reluctance to order last resort remedies like dissolution and buy out. On the other hand the parallelism between the development of alternative remedies, the broadening of the interpretation of oppression and the willingness of courts to order more drastic remedies has already been stressed many times.

Alternative remedies are supposedly less severe and as such best used when the majority is not engaged in constant wrongful conduct. Thus, when dissension is linked to one issue and there is a reasonable likelihood that once it is solved the business will be operated smoothly. In such situation a milder remedy is more likely to ease dissension. Stated differently, alternative remedies work best where they are least needed, in resolving trivial disagreements.

Some states have explicit laundry list of alternative remedies for all corporations. Those with close corporation statute often limited various alternative reliefs to these corporations. A few states broadly authorize courts to provide any equitable relief that is deemed appropriate.

The remedies usually listed are: removal and appointment of directors and officers, setting aside corporate action, cancellation of charter and bylaw provisions, accounting.

572 Haynsworth, supra note 316 at 26
573 Hetherington, Illiquidity, supra note 29 at 19-20
574 Murdock, supra note 31 at 461; Arthur D. Spratlin, Jr., Modern remedies for oppression in the closely held corporation, 60 Miss. L. J. 405, 418 (1990)
575 Bahls, supra note 194 at 311, 328-329
576 Hetherington, Illiquidity, supra note 29 at 21
577 E.g. Illinois, Maine, North Carolina, South Carolina
578 E.g. Arizona, Maryland, New York (buy out for close corporations), Montana, Wisconsin.
579 California and North Dakota and similar but only for close corporations Arizona, Texas and Wisconsin.
appointment of custodians, receivers and provisional directors, dividend payment and award of damages.

Some statutes explicitly recognize that the list of ordinary reliefs is merely representative and that courts retain power to order any other relief not cited in the list that seems appropriate. Thus many states legislatures reaffirmed courts power to fashion broad and creative equitable relief. Accordingly, courts have held that alternative reliefs can be granted on equitable grounds even though not available in the statute. In Alaska Plastics Inc. v. Coppock, for instance, the court stated that trial courts have the power to provide alternative remedies. While in Balvik v. Sylvester the court listed ten possible alternative remedies that court can fashion in equity, including a mandatory buy out. In jurisdiction where courts refused to use their equity power the statutory list becomes exclusive.

The trial courts play a predominant in alternative remedies cases because the appellate court usually confirm judgments of the trial level. These deference to the trial judge is justified by the unique opportunity the judge has to view all the facts in their totality.

Here to a valid question is if the same level of oppression is required to get an alternative relief, as is necessary to get a dissolution or buy out? (supra VI.A.2. and infra VI.B.3.) Some statutes explicitly state that alternative reliefs can be sought for less.

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580 Model Stat. Close Corp. Supp. § 41(a)
581 e.g. S.C. Code Ann. § 33-14-310.
582 Bahls, supra note 194 at 288 (supra V ?? for a discussion of the history of courts recognizing their rights to fashion equitable relief in the corporate context, and the relation, between enactment of a list of alternative remedies and equity power, and between close corporate statutes and general corporate codes).
583 Henderson, supra note 349 at 214; Bahls, supra note 194 at 313-315.
584 621 P.2d 270 (Alaska 1980)
585 411 N. W.2d 383 (N. D. 1987)
586 Haynsworth, supra note 316 at 41.
egregious conduct than that necessary to trigger dissolution\textsuperscript{587}. It appears in general that courts use alternatives for lesser degree of oppression\textsuperscript{588}.

While alternative reliefs seem to be less drastic, more adapted remedies, they have some major drawbacks. Alternative remedies are a burden for the judicial system. Firstly their is a risk of recurring litigation. Alternative remedies do not terminate the corporate coexistence. If a party is engaged in a scheme of oppression, such remedies will only delay the unavoidable dissolution or buy out. Secondly courts should not order remedies that they cannot monitor and in force. Enforceability is however jeopardized by a bad faith (or incompetent) majority\textsuperscript{589}. Finally alternative remedies are most of the times impractical because to expensive. In fact alternative remedies play a role as “prophylactic measures” while the merits of a dissolution or buy out suit are being debated. To attempt to reach long term solutions under these remedies seems unrealistic if not unwise\textsuperscript{590}. For those who see buy out as the natural remedy for dissension, alternative remedies are superfluous “and lead to an arbitrary and inefficient state of affairs”\textsuperscript{591}. Despite the widespread inclusion of alternative remedies in statutes they are not used often\textsuperscript{592}.

Alternative remedies have been classified in various ways. The “supplement” has a system of tiering of remedies. Dissolution is the last resort remedy after then buy out. Both are “extraordinary” reliefs. The alternative remedies are “ordinary” remedies who’s application must be evaluated in first instance\textsuperscript{593}. Alternative remedies have also been

\textsuperscript{587} E.g. S.C. Code Ann. § 33-14-310
\textsuperscript{588} Haynsworth, \textit{supra} note 316 at 63
\textsuperscript{589} Bahls, \textit{supra} note 194 at 306-307
\textsuperscript{590} Hetherington, \textit{Illiquidity}, \textit{supra} note 29 at 25
\textsuperscript{592} Thompson, \textit{Shareholder’s Cause}, \textit{supra} note 24 at 723
\textsuperscript{593} Model Stat. Close Corp. Supp. § 41-43
named “remedies allowing continued co-ownership”594. This classification emphasizes the non-definitive character of these solutions. Many of the alternative remedies are so called “third party devices”. They bring in an outsider to resolve the dispute595. Remedies can also be distinguished by the ground on which they are sought, oppression statute or breach of fiduciary duties. Breach of fiduciary duties allows a plaintiff to request preliminary injunctive, final equitable and monetary relief596.

2. The principal alternative remedies

a. Order compelling dividend payment

For an unemployed shareholder of a close corporation, failure to pay dividend deprives him from any return on investment. Some courts have therefore issued orders compelling dividend payment597. Although such orders are not to burdensome for the majority and often provide to the minority the desired relief courts require a high standard of proof. Arbitrary, fraudulent or bad faith action must be proved to overcome courts reluctancy, strengthen by the business judgment rule presumption598. An additional difficulty is to determine the amount of dividends that should be paid599. Courts have

594 Bahls, supra note 194 at 306-307 (partitioning, however, like dissolution and buy out is a definitive remedy)
595 Haynsworth, supra note 316 at 26 (using this classification for a provisional director, custodial receiver or arbitrator)
597 Crowley v. Communications for Hospitals, Inc. 30 Mass App. Ct. 751 (1991); Kisner v. Coffey, 418 So. 2d 58, 62 (Miss. 1982); (See also supra. ?? for orders compelling dividend payments)
598 Bahls, supra note 194 at 308
599 O’NEAL’S, OPPRESSION, supra note 104 at §3:05 list factors court should weigh before declaring a dividend: 1) amount of surplus in the corporation 2) ratio of current assets to current liabilities 3) working capital needed by the business 4) working capital retained in prior years 5) business prospects 6) possible future liabilities 7) whether a majority shareholder used his/her controlling position for his/her own benefit 8) any special interests that are not shared by the minority shareholders in keeping the interest minimal.
sometimes ordered that reasonable dividend be paid in the future to overcome the ad-hoc solution character of dividend payment orders. The need for flexibility of such long term orders prevent them to specify any amount.

b. Third party devices

Courts do not frequently use third party devices. The main advantage, of appointing people to exercise a role in the corporation, is that they will in effect play the role of in-house arbitrators. Especially in family owned businesses they can play a crucial role to resolve disputes, force key resignations and restructure the balance of power. Judicially monitored management is costly both in judicial expenses and lost opportunities. Judicial manages have a tendency to preserve the status-quo. Since they have no interest in the corporation, they are reluctant towards any innovative or aggressive initiative.

(i) Receivers (or Custodians)

Are usually appointed to liquidate the corporation, occasionally to manage it if a dissolution is impracticable or unnecessary. Custodians in effect temporarily replaces the board of directors and the officers. In some state courts can also order direct judicial supervision. Receivers, however are not an ideal solution. They make customers and

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600 Smith v. Atlantic Properties, Inc. 12 Mass. App. Ct. 201 (1981) (on appeals the court found that such order needs to be more precise)
601 Bahls, supra note 194 at 308
602 ld.
603 ld. at 308-309
604 Hetherington, Illiquidity, supra note 29 at 25-26
605 Haynsworth, supra note 316 at 28
creditors nervous. Moreover they are too expensive for most close corporations. If the receive is incompetent he may injure the business to an extent that parties would have been better off with an immediate dissolution. These remedies have rarely been ordered.

(ii). Provisional directors and Fiscal agents

Provisional directors and fiscal agents have fewer powers than custodian and receivers. Provisional directors have only one vote and thus cannot manage the whole business. Their role is less intrusive than that of a receiver and thus less damaging. They are ideal to resolve deadlock. Courts appoint them almost exclusively on statutory grounds. The majority can theoretically always dismiss the provisional director without court approval. In equity jurisdiction a charter provision could be necessary. Normally once the director has plaid is role as tie breaker and the harmony is restored the court will dismiss him. An objection to provisional directors is that no public policy reason justify depriving the blocking group from his veto. Veto powers are essential property rights, often bargained for by minorities to be protected. However, some deadlock require to be broken in everybody’s interest. Even though it is true that the appointment of a

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606 Bahls, supra note 194 at 309
607 Hetherington, Illiquidity, supra note 29 at 24; In Delaware however the remedy is more used because it is the only one available in case of shareholder dissension. Thompson, Shareholder’s Cause, supra note 24 at 723 n. 164
608 Haynsworth, supra note 316 at 27
609 Id. at 26
610 Corporate statutes having listed the remedy are e.g.: California, Maine, New Jersey, Ohio. Close corporate statutes listing it are: Delaware, Kansas, Montana, Pennsylvania, Texas, Wisconsin.
611 Haynsworth, supra note 316 at 27
612 Hetherington, Illiquidity, supra note 29 at 21
provisional director may push one of the parties in a minority position for a period of time on a whole range of issues where no intervention was necessary.\textsuperscript{613}

Fiscal agents have a limited power to review expenses. Parties can then petition for relief\textsuperscript{614}.

c. Surgically -Fashioned remedies

Those remedies result mostly from the use of the courts of their equitable powers. Their flexibility reflect the willingness of courts to recognize the complexity and factualness of close corporation disputes. Courts have ordered removal of directors, payment of salaries, nullification of corporate action and accounting\textsuperscript{615}. The preliminary injunctive relief for breach of fiduciary duty also fits in this category. They consist mainly of injunctions prohibiting, e.g., termination of employment\textsuperscript{616}.

d. Partitioning of property

Is an alternative to buy out. A division in viable units must be feasible. In consequence, few corporation qualify. The main advantage of partitioning is that it offers a definitive solution where parties still can see their reasonable expectations fulfilled. The complexity of such order however reduces the likelihood that courts will consider it\textsuperscript{617}.

\textsuperscript{613} Id. at 22
\textsuperscript{614} Bahls, supra note 194 at 310
\textsuperscript{615} Id. at 311
\textsuperscript{616} Billings, supra note 280, 596 at 5
\textsuperscript{617} Bahls, supra note 194 at 305-306
e. Damages

Are also a result of tort actions or actions for breach of fiduciary duties. They can be awarded for stock repurchase below fair value, for wrongful termination and for overcompensation.

3. Standards for finding the appropriate remedy

Neither courts nor statutes have focussed on standards to select the appropriate remedy. If they did so they tried to balance the hardship the remedy caused to the minority, majority, other businesses and the public. Hetherington and Dooley avoid the question of selection by proposing one exclusive remedy, i.e., buy out.

The “supplement” does not really provide a standard for choosing the appropriate remedy however it provides that alternative remedies should be evaluated before buy out and buy out before dissolution. Courts need however broad discretion to fashion a remedy. Therefore “the supplement” explicitly refuses to provide detailed standards. It mentions precedents of courts using equity power as a useful guide.

However broad standards could bring about legal certainty without unduly restricting courts remedial adaptability. A good standard is socially efficient. This

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618 Billings, supra note 280, 596 at 6-9
619 Wilkes v. Springside Nursing Home, Inc., 370 Mass. 842, 353 N.E. 2d 657 (1976) (he was awarded as damages “the salary he would have received had he remained an officer and director”)
620 Sugarman v. Sugarman, 797 F.2d 3 (1st Cir. 1986) (aberrant overcompensation gave rise to a direct action, damages were awarded)
621 Bahls, supra note 194 at 315-316
622 Hetherington, Illiquidity, supra note 29 at 34-59
624 ld. at § 41 (official comment)
625 Bahls, supra note 194 at 316
means that it is equitable because it protects reasonable expectations of parties and redistributes income in accordance with the proportionate interest of the participants. The standard is also efficient in that it minimizes economic waste (value but also more subjective elements as “goodwill”).

Bahls proposes a standard for selecting remedies not to rigid as to lead to inappropriate results and not to flexible as to amount to a simple admonishment to consider facts and circumstances. In an oppression case following standards of selection should be considered:

(1) The remedy should maximize the ability of minority shareholders to realize their reasonable expectations. The use of this standard is certainly appropriate since courts use it in first instance to decide if they will grant relief. When this is not possible for both parties it is supposedly because dissolution or buy out is more appropriate  (2) the remedy should minimize the administrative costs associated with resolving the dissension. Concerns problems of procedural expenses, recurring litigation and enforceability (3) The remedy should maximize the value of the economic unit while allowing shareholders to realize the value in accordance with their reasonable expectations. Thus, not only avoid net loss, but also maximize the ability of the corporation to attract future financing

4. A flexible corporate law

Statutes should provide exhaustive (non exclusive) lists of alternative remedies. The availability of such remedies increases the flexibility of the law. In the corporate context such flexibility is necessary to adapt to the facts of each case. Courts should not be put in a situation where they can only choose between dissolution and buy out.

626 Id. at 318-320 (citing W Hirsh, LAW AND ECONOMICS: AN INTRODUCTORY ANALYSIS 4 (1988))
Nevertheless it must be admitted and kept in mind that alternative remedies are not always adapted. The situation in which they can be used efficiently are very rare. In fact only for superficial dissension in close corporation who can afford the price of those remedies.

C. Shareholder agreements and other protections

1. Agreements. efficient but rare

Shareholders’ agreements are certainly the most economic alternative to judicial conflict resolution\(^627\). A well drafted agreement will not only allow smooth conflict resolution but will deter and forbid oppressive conduct. Moreover, they can be tailored to the specific needs of each close corporation.

For optimal agreements it must be assumed that the general or the close corporate law is so flexible as to permit various contractual provisions. As we saw (supra II) it can generally be stated that this is the case, certainly for close corporations.

Undeniable is that shareholder agreements, how well drafted, cannot resolve and anticipate every form of oppression\(^628\). The imagination of oppressive shareholders and the variety of techniques can never be fully covered. Agreements are also often drafted on the false assumption that participants will wish to continue to manage the business together. A doubtful assumption in case of serious dissension\(^629\). Moreover, as discussed, the expectations of future close corporate shareholders are based on trust and confidence. This already restricts their ability to contract. Demonstrating little confidence

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\(^{627}\) Brownlee, *supra* note 320 at 295

\(^{628}\) Hetherington, *Illiquidity*, *supra* note 29 at 36

\(^{629}\) *Id.* at 37
to the majority could queer the deal\textsuperscript{630}. Parties also refuse to contract because they realize that contractual protection, increases the risk of deadlock and abuse\textsuperscript{631}. Instead of relying on inaccurate provisions they will prefer to count on, low transaction cost, more reliable statutory remedies\textsuperscript{632}.

We discuss briefly below some of the most common agreements. The list is naturally not exhaustive

a. Buy out agreement

A buy out agreement regulates withdrawal of investment under a set of given circumstances or at will\textsuperscript{633}. Classically, withdrawal will be allowed if the majority engages in a squeeze out or if corporate employment is terminated. The majority is than bound to purchase the shares of the withdrawing shareholder. Eventually the right to dissolve the corporation is provided in cases of refusal to purchase by the majority.

Buy/sell shoot-out agreements are also frequent. A shareholder can offer to buy the shares of other shareholders, who than in turn can offer to purchase offeror’s stock on the same terms\textsuperscript{634}. Well drafted buy out provisions provide methods of valuation or refer to an independent third party if no fixed price is determined. Like for court ordered buy outs, buy out agreement have as major drawback the financial burden they put on the corporation and its shareholders\textsuperscript{635}.

\textsuperscript{630} Id. at 36-37
\textsuperscript{631} Thompson, Shareholder’s Cause, supra note 24 at 705
\textsuperscript{632} Shishido, supra 511 note at 92-93
\textsuperscript{633} Brownlee, supra note 320 at 298 -300 (for a description of the content of buy out agreements)
\textsuperscript{634} Haynsworth, supra note 316 at 30
\textsuperscript{635} Id. at 30, 91 ("buy out arrangement . . . in many situations will be impractical because of the expense")
b. Compulsory dividend agreements

Require the corporation to declare dividend under defined circumstances. Usually, when sources of dividend grow beyond a certain level. If dividends are withhold the agreement can provide that the minority can elect a majority of directors. Dividend policy will immediately be redressed\textsuperscript{636}. Two consideration should guide such agreements. First that it is often fiscally wiser to distribute earnings via salary than via dividends. Second that enough flexibility should be retained such as to permit investment of earnings for corporate expansion or adaptation.

c. Employment contracts

Sensible employment contracts covering long periods with defined salaries, eventually adaptable to the corporations' profitability, provide essential protection\textsuperscript{637}. However, such agreements collide with the employment at will doctrine. A doctrine that has been reevaluated in close corporations (supra ?? pedro ? for instance). Golden parachute provisions sometimes allow to circumscribe this hurdles.

d. Minority veto power

To directors or shareholders. Guarantees participation of the minority in the decision making process\textsuperscript{638}. Those provisions increase potential deadlocks.

\textsuperscript{636} Brownlee, supra note 320 at 304
\textsuperscript{637} \textit{Id.} at 302-304
\textsuperscript{638} \textit{Id.} at 301-302
e. Arbitration.

Most state enforce arbitration agreements. They can be used to solve intra-corporate disputes. They are certainly successful for valuation of shareholders’ stock. But less for deep rooted shareholders conflict.

f. Other protective provisions

Are meant: non compete covenants and preemptive rights (right of first refusal). The first provision protect the shareholders from disruptive competition of co-shareholders. While the seconds protect minority (and majority) from unwanted (and potentially oppressive) co-venturers. They also allow to avoid dilution of the shares of the minority. Many other clauses are used in shareholder agreements. E.g. so called anti-Donahue clauses restricting the fiduciary duties of the close corporate participants or other agreements exculpating directors and officers, indemnity clauses and clauses concerning third beneficiaries.

2. Other protections

We briefly mention a few other remedies that can be invoked in oppression cases. If a purchase of stock is involved securities law can be invoked. The catch all rule 10b concerning employment of manipulative and deceptive devices plays a prominent role in

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639 Haynsworth, supra note 316 at 29
640 Brownlee, supra note 320 at 306-307
641 Id. at 300-301
642 Billings, supra note 280, 596 at 20-22 (discussing some of these clauses)
643 See generally, O’NEAL’S, OPPRESSION, supra note 104
644 Securities and Exchange Act of 1934
share transfer litigation. For going private transaction and freeze out mergers rescission or damages can be obtained (rescissory damages or principal plus interest damages). Finally, as an exclusive remedy, appraisal is possible. Appraisal can be invoked for essential corporate changes. In close corporations courts have accepted a broader range of actions that trigger dissenter’s rights.

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645 Billings, supra note 280, 596 at 10-12 (discussing remedies for freeze out going private transactions); See generally Crago, supra note 215 (for a discussion of cash out mergers in close corporations, compared to public corporations and the available remedies)

646 Model Bus. Corp. Act § 13.02 (for a merger plan, a share exchange plan, for sale of substantial corporate property, for important amendments to the articles of incorporation)

Chapter VII. Conclusion

The content of corporate law is defined by a few considerations. It must lower transaction cost by providing the provisions parties would have bargained for. The so-called standard contract function of corporate law. Corporate law must also provide protection for parties who are not in a position to do so. Corporate law protects outsiders and insiders. Outsiders, like for instance, creditors and customers are protected with rules concerning disclosure of financial information or rules concerning liability and representation. For insiders, it is the minority who is in need of protection. Ideally they will bargain for it. This is why corporate law and especially the law of close corporation is increasingly flexible. However, in most cases they do not. Corporate law must then provide default protection rules.

The dissolution and buy out remedy are expressions of these default rules. The availability of such drastic remedies is supported by three policy choices.

Investors in a corporation decide to dedicate their participation to a common business goal. The risk of failure must be supported by all investments commonly and equally (meaning, in most cases proportionality). Shareholders cannot withdraw without that their investments bear the loss due to failure. However, shareholders' obligation to support the risk is limited by the right not to be oppressed. Oppression is measured as a frustration of reasonable expectations. When the oppressive conduct also amounts to fault and wrongdoing by the majority interventions seems obvious. But frustration of reasonable expectations is sometimes simply dictated by sound business considerations. The frustration is caused by the necessity of the corporation to adapt to business failure. The participants in fact did a wrong investment. Should the minority then still be
protected? Reasonable expectations in such cases are not frustrated because the minority is fired or receives a lesser dividend. The oppressions lays in the distribution of the burden of the failure. The minority should not bear higher costs of failure than the majority. To the extent majority allocates a disproportionate amount of failure to the minority, they oppress. Even though externally, majority’s decisions seem motivated by sound business judgment.

The second consideration supporting dissolution and buy out is that the necessity of intervention prevails permanence. Minority shareholders cannot expect withdrawal at will but they have the right to expect judicial intervention when their “contract” is breached. Dissolution and buy out reflect this necessity for judicial intervention and the continuous balancing between permanence and relief. Permanence is one of the main characteristics of corporations. But permanence is two sided. No investment can be considered permanent with disregard to the behavior of those who manage the investment. This right to withdraw is triggered by the misbehavior of those who profit most of the stability of the financial structure of the corporation. It should thus prevail over corporate permanency.

Thirdly, serious dissension can only be solved by withdrawal of a party. In close corporations good will and friendly cooperation is essential for day to day operations. When dissension is deep rooted only withdrawal can bring relief. All other solutions are ephemeral and unrealistic.

The availability of buy out more than any other remedy transformed the position of, previously helpless, minority shareholders. Dissolution only guarantees to the minority liquidation value minus expenses. Thus, dissolution while a tremendous threat for a majority who wants to continue the business, because it could result in liquidation, is not optimal for the minority. Only when the dissolution procedure is used as additional leverage in a buy out negotiation, is it useful. Dissolution plays then the role of price
fixing mechanism. Thus, dissolution is in most cases an unnecessary step. The result aimed at by both parties is buy out. The right to directly request buy out reflects this aim. It also allows to value the shares at a higher value than liquidation value. This is indispensable when oppression resulted in a worthless corporation and the majority is willing to dissolve. Direct buy out has then a fully remedial function. Finally, buy out is more acceptable to cautious judges, who still distrust dissolution, because it is so drastic.

Other alternative remedies are adapted for lesser conflicts. The context in which they can be used efficiently is rare. They are or too expensive for little close corporations. This is the case of third party devices. Or they are ephemeral. For instance, an order to compel dividends. While the applicability of alternative remedies is not totally excluded, their unimportance is reflected by the few amount of cases where they were ordered.

Buy out is not a perfect solution. The remedy is slow. Valuation is unpredictable and the procedure is costly. However, considering the whole panoply of remedies, the availability of buy out appears to be indispensable. From the three definitive remedies. (dissolution, buy out and partitioning) buy out is the most practical. It is certainly more adapted, for a healthy business, than dissolution. Buy out redressed the balance of powers between the majority and the minority more than any other remedy. This thesis therefore concludes by pleading for a widespread acceptance of the right to directly request buy out in case of oppression.

-P. A. Agabin, Annotation, Duty and liability of closely held corporation, its directors, officers, or majority stockholders, in acquiring stock of minority shareholder, 7 A.L.R. 3d 500 (suppl. 1996)

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