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Corporate Behavior and the Minority Shareholder: Contrasting Interpretations of Section 10-19.1-115 of the North Dakota Century Code

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CORPORATE BEHAVIOR AND THE MINORITY SHAREHOLDER: CONTRASTING INTERPRETATIONS OF SECTION 10-19.1-115 OF THE NORTH DAKOTA CENTURY CODE

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I. INTRODUCTION

In 1985, the North Dakota Legislature substantially revised North Dakota's Business Corporation Act.[1] The revised Act, which will govern every North Dakota corporation by July 1, 1986,[2] embodies a new involuntary dissolution statute.[3] The new statute

1. *See* Act of Apr. 4, 1985, ch. 117, 1985 N.D. Sess. Laws 332 (codified at N.D. CENT. CODE ch. 10-19.1 (1985)).

2. N.D. CENT. CODE § 10-19.1-04 (1985). After June 30, 1986, the revised Act applies to all existing North Dakota corporations. *Id.* Corporations in existence prior to July 1, 1985 may elect, after June 30, 1985 and before July 1, 1986, to be governed by the revised Act. *Id.* § 10-19.1-03. Corporations incorporated after June 30, 1985 are governed by the revised Act. *See id.* § 10-19.1-02.

3. *Id.* § 10-19.1-115. Section 10-19.1-115 of the North Dakota Century Code provides as follows:

> 1. A court may grant any equitable relief it deems just and reasonable in the circumstances or may dissolve a corporation and liquidate its assets and business:
>   a. In a supervised voluntary dissolution pursuant to section 10-19.1-114;
>   b. In an action by a shareholder when it is established that:
>   (1) The directors or the persons having the authority otherwise vested in the board are deadlocked in the management of the corporate affairs and the shareholders are unable to break the deadlock;
>   (2) The directors or those in control of the corporation have acted fraudulently, illegally, or in a manner unfairly prejudicial toward one or more shareholders in their capacities as shareholders, directors, or officers,or as employees of a closely held corporation;
>   (3) The shareholders of the corporation are so divided in voting power that, for a period that includes the time when two consecutive regular meetings were held, they have failed to elect successors to directors whose terms have expired or would have expired upon the election and qualification of their successors;
>   (4) The corporate assets are being misapplied or wasted; or
>   (5) The period of duration as provided in the articles has expired and has not been extended as provided in section 10-19.1-124.
>   c. In an action by a creditor when:
>   (1) The claim of the creditor has been reduced to judgment and an execution thereon has been returned unsatisfied; or
>   (2) The corporation has admitted in writing that the claim of the creditor is due and owing and it is established that the corporation is unable to pay its debts in the ordinary course of business; or
>   d. In an action by the attorney general to dissolve the corporation in accordance with section 10-19.1-118 when it is established that a decree of dissolution is appropriate.
> 2. In determining whether to order equitable relief or dissolution, the court shall take into consideration the financial condition of the corporation but may not refuse to order equitable relief or dissolution solely on the ground that the corporation has accumulated or current operating profits.
> 3. In determining whether to order equitable relief or dissolution, the court shall take into consideration the duty which all shareholders in a closely held corporation owe one another to act in an honest, fair, and reasonable manner in the operation of the corporation and the reasonable expectations of the shareholders as they exist at the inception and develop during the course of the shareholders' relationship with the corporation and with each other.
> 4. If the court finds that a party to a proceeding brought under this section has acted arbitrarily, vexatiously, or otherwise not in good faith, it may in its discretion award reasonable expenses, including attorneys' fees and disbursements, to any of the other parties.
> 5. Proceedings under this section must be brought in a court within the county in which the registered office of the corporation is located. It is not necessary to make shareholders parties to the action or proceeding unless relief is sought against them personally.

Id.

significantly expands the statutory grounds a court may rely on to order involuntary dissolution.[4] According to the new statute, "[a] court may grant any equitable relief it deems just and reasonable in the circumstances or may dissolve a corporation and liquidate its assets and business" in any number of specified situations.[5]

The new involuntary dissolution statute proscribes certain types of corporate behavior.[6] The proscriptions of the former

4. *Compare* Act of Mar. 8, 1983, ch. 138, § 1, 1983 N.D. Sess. Laws 381, 381, *repealed by* Act of Apr. 4, 1985, ch. 147, § 24, 1985 N.D. Sess. Laws 332, 429 (current version at N.D. CENT. CODE § 10-19.1-118 (1985)) *with* N.D. CENT. CODE § 10-19.1-115 (1985). The former statute provided for the district court to decree involuntary dissolution only when a corporation procured its articles of incorporation through fraud, continued to exceed or abuse the authority conferred upon it by law, failed for thirty days to appoint and maintain a registered agent in the state, failed for thirty days after change of its registered office or registered agent to file a statement of the change in the office of the secretary of state, or failed for five years after the date of issuance of its certificate of incorporation or certificate of organization to commence business and issue shares. Act of Mar. 8, 1983, ch. 138, § 1, 1983 N.D. Sess. Laws 381, 381, *repealed by* Act of Apr. 4, 1985, ch. 147, § 24, 1985 N.D. Sess. Laws 332, 429 (current version at N.D. CENT. CODE § 10-19.1-118 (1985)). The revised Act retains most of the grounds for involuntary dissolution which are located in § 10-19.1-118 of the North Dakota Century Code, and adds the new grounds for dissolution which are set forth in § 10-19.1-115. *See* N.D. CENT. CODE §§ 10-19.1-115, -118 (1985). See *supra* note 3 for the text of § 10-19.1-115.

5. N.D. CENT. CODE § 10-19.1-115(1) (1985). Subsection 10-19.1-115(1) of the North Dakota Century Code lists specific grounds that authorize a court to dissolve a corporation and liquidate its assets, but the broad grant of equitable powers to the court also allows the court to fashion *any* remedy short of dissolution that it deems just and reasonable. *See id.* For the text of § 10-19.1-115(1), see *supra* note 3. One commentator has developed a list enumerating a wide variety of equitable remedies supposedly available to a court under Minnesota's involuntary dissolution statute, including:

> (1) Cancelling, altering, or enjoining any resolution or other act of the corporation;
> (2) Directing or prohibiting any act of the corporation or of shareholders, directors, officers, or other persons party to the action;
> (3) Cancelling or altering any provision contained in the articles of incorporation or by-laws of the corporation;
> (4) Removing from office any director or officer, or ordering that a person be appointed a director or officer;
> (5) Requiring an accounting with respect to any [business] matters in a dispute;
> (6) Appointing a custodian to manage the business and affairs of the corporation;
> . . .
> (10) Awarding damages to any aggrieved party in addition to, or in lieu of, any other relief granted;
> (11) Ordering the payment of dividends;
> (12) Issuing an injunction to prohibit continuing acts of unfairly prejudicial conduct;
> (13) Permitting minority stockholders to purchase additional stock under conditions specified by the court;
> (14) Ordering dissolution of the corporation at a specified date, to become effective only in the event that the stockholders fail to resolve their differences prior to that date; [and]
> (15) Ordering that the corporation be liquidated and dissolved unless either the corporation or one or more of the remaining shareholders has purchased all of the shares of another shareholder at their fair value by a designated date.

Olson, *A Statutory Elixir for the Oppression Malady*, 36 MERCER L. REV. 627, 643-45 (1985). This list of possible remedies may be just as applicable to North Dakota's involuntary dissolution statute because the Minnesota and North Dakota statutes are, in large part, identical. *Compare* N.D. CENT. CODE § 10-19.1-115(1) (1985) *with* MINN. STAT. ANN. § 302A.751 (1) (West 1985).

6. *See* N.D. CENT. CODE § 10-19.1-115 (1985). Section 10-19.1-115 provides that a corporation may not misapply or waste assets, nor may the directors or those in control act in an unfairly prejudicial manner toward the other shareholders. *Id.* § 10-19.1-115(1) (b) (2), (1) (b) (4). For the text of § 10-19.1-115, see *supra* note 3.

statute were few and the statute's remedy was available only through an action brought by the attorney general.[7] In contrast, the new statute condemns a wider variety of corporate behavior[8] and its remedies are available through actions brought by shareholders,[9] creditors,[10] or the attorney general.[11]

This Article addresses one particular application of the new statute and the manner in which that application may affect corporate behavior. Subsection 10-19.1-115(1)(b)(2) of the North Dakota Century Code now allows a shareholder to obtain relief when it is established that "[t]he directors or those in control of the corporation have acted fraudulently, illegally, or in a manner unfairly prejudicial toward one or more shareholders in their capacities as shareholders, directors, or officers, or as employees of a closely held corporation."[12] A shareholder who can prove such activity on the part of the directors or controlling shareholders[13] now has access to a statutory remedy. Under the former statute, a shareholder found little relief.[14]

The application of subsection 10-19.1-115(1)(b)(2) is to be guided by another new provision, subsection 10-19.1-115(3).[15] In determining whether to order equitable relief or dissolution, subsection 10-19.1-115(3) provides:

> [T]he court shall take into consideration the duty which all shareholders in a closely held corporation owe one another to act in an honest, fair, and reasonable manner

7. *See* Act of Mar. 8, 1983, ch. 138, § 1, 1983 N.D. Sess. Laws 381, 381, *repealed by* Act of Apr. 4, 1985, ch. 147, § 24, 1985 N.D. Sess. Laws 332, 429 (current version at N.D. CENT. CODE § 10-19.1-118 (1985)). For a discussion of the former North Dakota dissolution statute, see *supra* note 4. *See also* State *ex rel* Langer v. Gamble-Robinson Fruit Co., 44 N.D. 376, 176 N.W. 103 (1919) (corporate charter may be cancelled in action by attorney general when corporation has participated in a combination to fix prices and thereby abused its authority).

8. *Compare* Act of Mar. 8, 1983, ch. 138, § 1, 1983 N.D. Sess. Laws 381, 381, *repealed by* Act of Apr. 4, 1985, ch. 147, § 24, 1985 N.D. Sess. Laws 332, 429 (current version at N.D. CENT. CODE § 10-19.1-118 (1985)) *with* N.D. CENT. CODE § 10-19.1-115(1) (1985). For the types of corporate behavior proscribed by the new involuntary dissolution statute, see *supra* note 3.

9. N.D. CENT. CODE § 10-19.1-115(1)(b) (1985).

10. *Id.* § 10-19.1-115(1)(c).

11. *Id.* § 10-19.1-115(1)(d).

12. *Id.* § 10-19.1-115(1)(b)(2).

13. For purposes of this article, the term "controlling shareholders" will be substituted for the phrase "those in control" as used in § 10-19.1-115(1)(b)(2) of the North Dakota Century Code. *See* N.D. CENT. CODE § 10-19.1-115(1)(b)(2) (1985).

14. *See* Act of Mar. 8, 1983, ch. 138, § 1, 1983 N.D. Sess. Laws 381, 381, *repealed by* Act of Apr. 4, 1985, ch. 147, § 24, 1985 N.D. Sess. Laws 332, 429 (current version at N.D. CENT. CODE § 10-19.1-118 (1985)). Only the attorney general could bring an action under the former North Dakota involuntary dissolution statute. *Id.* If the wrong party brought an action under the statute, the attorney general had to be substituted as the proper party plaintiff. *See* State v. Movius Land & Loan Co., 53 N.D. 656, 666, 207 N.W. 492, 495-96 (1926) (substitution of attorney general as party plaintiff cured original defect and allowed proceedings to continue as if originally commenced by attorney general).

15. *See* N.D. CENT. CODE § 10-19.1-115(3) (1985).

> in the operation of the corporation and the reasonable expectations of the shareholders as they exist at the inception and develop during the course of the shareholders' relationship with the corporation and with each other.[16]

These new provisions bring a number of new concepts to North Dakota. Courts and practitioners must begin to assess what type of behavior constitutes "unfairly prejudicial conduct," what it means for a corporation to act in an "honest, fair, and reasonable manner," and how a shareholder's "reasonable expectations" affect her right to recovery. This Article does not provide a "correct" interpretation of these concepts. Rather, it examines the provisions of the North Dakota involuntary dissolution statute within the context of two frameworks. The first framework justifies court intervention into corporate affairs to protect shareholders from unfair acts. The second framework justifies a court's nonintervention and endorsement of the acts of the directors and controlling shareholders. These frameworks not only provide the arsenal with which to attack and defend corporate acts and behavior, but also underscore the inherently political nature of the law.[17]

This Article is limited to the application of the above provisions to closely held corporations.[18] Part II describes the closely held corporation and the unique problems that confront it and its shareholders. Part III describes the intervention framework, the framework that the oppressed minority shareholders look to for relief. Part IV describes the nonintervention framework, the

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16. *Id.*

17. *See* Kennedy, *Legal Education as Training for Hierarchy,* in THE POLITICS OF LAW: A PROGRESSIVE CRITIQUE 40 (D. Kairys ed. 1982). Kennedy argues that the legal rules and legal reasoning taught in law are nothing more than political and economic justifications. Kennedy states:

> It is true that there are distinctive lawyers' argumentative techniques for spotting gaps, conflicts, and ambiguities in the rules, for arguing broad and narrow holdings of cases, and for generating pro and con policy arguments. But these are *only* argumentative techniques. There is never a "correct legal solution" that is other than the correct ethical and political solution to that legal problem.

Id. at 47; *see also* Singer, *The Player and the Cards: Nihilism and Legal Theory,* 94 YALE L.J. 1 (1984); Tushnet, *Following the Rules Laid Down: A Critique of Interpretivism and Neutral Principles,* 96 HARV. L. REV. 781 (1983); Note, *'Round and 'Round the Bramble Bush: From Legal Realism to Critical Legal Scholarship,* 95 HARV. L. REV. 1669 (1982).

18. A vast majority of the corporations in the United States may be considered closely held corporations. *See* Conrad, *The Corporate Census: A Preliminary Exploration,* 63 CALIF. L. REV. 440, 458-59 (1975) (nearly 95% of American corporations have 10 or fewer shareholders). In addition, remedies such as those that may be imposed pursuant to § 10-19.1-115(1) of the North Dakota Century Code have rarely, if ever, been imposed on corporations with more than 35 shareholders. *See* Olson, *supra* note 5, at 637 n.69.

framework that directors and controlling shareholders look to for protection. Finally, Part V examines the new North Dakota involuntary dissolution statute and its impact.

II. THE CLOSELY HELD CORPORATION

The term "closely held corporation"[19] has defied precise definition.[20] A closely held corporation typically has at least some of the following attributes: (1) the shareholders are few in number, often only two or three; (2) all or most of the shareholders are active in the business; (3) there is no established market for the corporate stock; and (4) the shareholders receive their return as employees in the form of salaries and benefits.[21] Although these characteristics are usually found in closely held corporations, exceptions exist.[22]

The most popular judicial definition of a closely held corporation is the one developed by the Massachusetts Supreme Judicial Court in *Donahue v. Rodd Electrotype Co.*[23] In *Donahue* the court deemed a closely held corporation to be typified by: (1) a small number of shareholders; (2) no ready market for the corporate stock; and (3) substantial majority shareholder participation in the management, direction, and operation of the corporation.[24]

Statutes now commonly define a closely held corporation as a corporation with no more than a certain number of shareholders.[25]

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19. The terms "close corporation" and "closely held corporation" are generally considered synonymous and may be used interchangeably. *See* 1 F. O'NEAL, CLOSE CORPORATIONS § 1.04 (2d ed. 1971). To be consistent with the Business Corporation Act, this Article will use the term "closely held corporation." *See* N.D. CENT. CODE § 10-19.1-01(6) (1985) (" 'Closely held corporation' means a corporation which does not have more than thirty-five shareholders").

20. *See* Donahue v. Rodd Electrotype Co., 367 Mass. 578, ____, 328 N.E.2d 505, 511 (1975); Israels, *The Close Corporation and the Law,* 33 CORNELL L.Q. 488, 491 (1948); Peeples, *The Use and Misuse of the Business Judgment Rule in the Close Corporation,* 60 NOTRE DAME L. REV. 456, 465 (1985).

21. 1 F. O'NEAL, *supra* note 19, § 1.07; *see* 1 F. O'NEAL & R. THOMPSON, OPPRESSION OF MINORITY SHAREHOLDERS § 1:03 (2d ed. 1985); *see also* Donahue v. Rodd Electrotype Co., 367 Mass. 578, ____, 328 N.E.2d 505, 511 (1975).

22. *See* Phelps v. Watson-Stillman Co., 365 Mo. 1124, ____, 293 S.W.2d 429, 431 (Mo. 1956) (corporation with 56 shareholders classified as closely held). It should also be noted that closely held corporations are not always small corporations, but often have tremendous assets and worldwide operations. For example, Ford Motor Company was commonly thought of as closely held until it went public in 1955. *See* 1 F. O'NEAL, *supra* note 19, § 1.03.

23. 367 Mass. 578, 328 N.E.2d 505 (1975).

24. Donahue v. Rodd Electrotype Co., 367 Mass. 578, 586, 328 N.E.2d 505, 511 (1975); *see also* Alaska Plastics, Inc. v. Coppock, 621 P.2d 270, 273 n.3 (Alaska 1980). Another popular judicial definition of a closely held corporation is "one in which the stock is held in a few hands, or in a few families, and wherein it is not at all, or only rarely, dealt in by buying or selling." Galler v. Galler, 32 Ill. 2d 16, 27, 203 N.E.2d 577, 583 (1965) (citing Brooks v. Willcuts, 78 F.2d 270, 273 (8th Cir. 1935)); *see also* Sorlie v. Ness, 323 N.W.2d 841, 845 n.2 (N.D. 1982).

25. The following states define closely held corporations by the number of shareholders: ALA. CODE § 10-2A-301(c) (1980) (30 shareholders); ARIZ. REV. STAT. ANN. § 10-203A(3) (1977) (10 shareholders); CAL. CORP. CODE § 158(a) (West 1982) (10 shareholders); DEL. CODE ANN. tit. 8, § 342 (1975) (30 shareholders); ME. REV. STAT. ANN. tit. 13-A, § 102(5) (1974) (20 shareholders); MINN. STAT. ANN. § 302A.011(6)(a) (West 1985) (35 shareholders); N.D. CENT. CODE § 10-19.1-01(6) (1985) (35 shareholders); R.I. GEN. LAWS § 7-1.1-51(d) (1982) (30 shareholders).

The use of a variety of maxima reflects the difficulty in defining the closely held corporation.[26] North Dakota's Business Corporation Act provides that a closely held corporation is "a corporation which does not have more than thirty-five shareholders."[27] While seemingly precise, some commentators have suggested that certain corporations that have more than the statutory maximum number of shareholders should be classified as closely held despite their failure to comply with the statutory definition.[28]

Because they are typically small businesses, closely held corporations are often thought of as partnerships in corporate form.[29] A small enterprise may decide to incorporate for any number of reasons including a desire to acquire limited liability and preferred tax treatment.[30] The incorporation decision is often given little thought by the participants. Rarely do the shareholders anticipate the problems that may arise, and even more rarely do they enter into agreements to deal with such problems.[31]

Invariably, the shareholders of a closely held corporation begin the corporation's existence with high hopes and a consensus

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26. *See* Hillman, *The Dissatisfied Participant in the Solvent Business Venture: A Consideration of the Relative Permanence of Partnerships and Close Corporations,* 67 MINN. L. REV. 1, 64 (1982) (statutory definitions of close corporations specifying a maximum number of shareholders reflect the range of viewpoints on what constitutes a close corporation).

27. N.D. CENT. CODE § 10-19.1-01(6) (1985).

28. *See, e.g.,* Olson, *supra* note 5, at 637 n 68. Olson suggests that when shareholding is broken down upon clearly defined lines, such as by families, it may be appropriate in certain circumstances to group shareholders before applying the numerical test. *Id.* Under this analysis, courts may apply either an objective or subjective test. The Minnesota courts have rejected at least one attempt to obscure the objective numerical test. *See* Sundberg v. Lambert Lumber Co., No. 465481 (Minn. App. July 11, 1986) (corporation with more than 35 shareholders not closely held).

29. *See, e.g.,* Donahue v. Rodd Electrotype Co., 367 Mass. 578, 586, 328 N.E.2d 505, 512 (1975) (incorporated partnerships); Westland Capitol Corp. v. Lucht Eng'g, 308 N.W.2d 709, 712 (Minn. 1981) (partnership in corporate guise). *See generally* Dickinson, *Partners in a Corporate Cloak: The Emergence and Legitimacy of the Incorporated Partnership,* 33 AM. U.L. REV. 559, 569 (1984) (in many cases, incorporated partnerships and close corporations are seemingly synonomous). The notion that closely held corporations are analogous to partnerships has received some criticism. *See* Hillman, *supra* note 26, at 64 (when a close corporation consists of 50 shareholders, it is questionable whether the relationship among shareholders bears a significant resemblance to a corporation or partnership with only two or three members).

30. *See* Exadaktilos v. Cinnaminson Realty Co., 167 N.J. Super. 141, ____, 400 A.2d 554, 560 (N.J. Super. Ct. Law Div. 1979), *aff'd per curiam,* 173 N.J. Super. 559, 414 A.2d 994 (N.J. Super. Ct. App. Div. 1980); 1 F. O'NEAL, *supra* note 19, § 1.08; Dickinson, *supra* note 29, at 566-67; Note, *Corporation Law*-Meiselman v. Meiselman: *"Reasonable Expectations" Determine Minority Shareholders' Rights,* 62 N.C.L. REV. 999, 1003-04 (1984).

31. *See* 1 F. O'NEAL & R. THOMPSON, *supra* note 21, § 2:19 (shareholders in close corporations often fail to appreciate potential problems); Dickinson, *supra* note 29, at 567 n.39 (lack of attention to detail may leave organization with a structure inadequate to ensure the achievement of its goals); O'Neal, *Close Corporations: Existing Legislation and Recommended Reform,* 33 BUS. LAW. 873, 883-84 (1978) (shareholders often fail to insist on a shareholders' agreement or appropriate charter or bylaw provisions). A new development is the bringing of malpractice suits against lawyers who have organized corporations without providing appropriate protection to minority shareholders. 1 F. O'NEAL & R. THOMPSON, *supra* note 21, at vii. The risk of malpractice liability is greatest when the lawyer has represented both majority and minority shareholders in the organization of the corporation. *Id.* Failure to include shareholder agreements that protect minority shareholders may be viewed by the minority shareholders as a failure of the lawyer's duty to represent them. *Id.*

concerning what the corporation is going to do and how it is going to operate.[32] But in its beginnings, the seeds of discord are often sown. Because the contributions of the shareholders may differ, individual stock ownership percentages may also differ, thereby creating a control position for one person or group.[33] Alternatively, the simple fact that there may be more than two shareholders creates the potential for the formation of a control group.[34]

Closely held corporations are generally formed with the idea that the two or three shareholders will be the employees, directors, and officers of the corporation.[35] They generally expect that they will receive their return primarily in the form of salaries rather than dividends.[36] Unfortunately, regardless of the shareholders' original intentions, time and human nature have a way of breaking down the consensus and creating a divergence of interests.[37] Personal relationships may become so strained that the shareholders find that they are no longer capable of working with each other.[38]

The case of *Meiselman v. Meiselman*[39] is reflective of much of the animosity and bitterness that often arises in shareholder disputes. In *Meiselman* two brothers owned all of the stock of several inter--

32. *See* Hetherington & Dooley, *Illiquidity and Exploitation: A Proposed Statutory Solution to the Remaining Close Corporation Problem*, 63 VA. L. REV. 1, 2-3 (1977) (typically, close corporations are formed by individuals who have a "complete identity of interests and strong feelings of trust for one another").

33. Davidian, *Corporate Dissolution in New York: Liberalizing the Rights of Minority Shareholders*, 56 ST. JOHN'S L. REV. 24, 26 (1981); *see also* Note, *supra* note 30, at 1004. The commentator contends that if the majority and minority shareholders cannot reconcile a disagreement over corporate policy, the disagreement will be resolved in favor of the majority shareholders. *Id.* This result occurs because the majority shareholders' control of the board of directors and ownership of the majority of voting shares allows them to control corporate decision making. *Id.*

34. *See, e.g.*, Wilkes v. Springside Nursing Home, Inc., 370 Mass. 842, ____, 353 N.E.2d 657, 659-61 (1976). For a discussion of *Wilkes*, see *infra* notes 61-75 and accompanying text.

35. O'Neal, *supra* note 31, at 884-85; Note, *Involuntary Dissolution of Close Corporations for Mistreatment of Minority Shareholders*, 60 WASH. U.L.Q. 1119, 1139-40 (1982); *see* Exadaktilos v. Cinnaminson Realty Co., 167 N.J. Super. 141, ____, 400 A.2d 554, 561 (N.J. Super. Ct. Law Div. 1979), *aff'd per curiam*, 173 N.J. Super. 559, 414 A.2d 994 (N.J. Super. Ct. App. Div. 1980) (plaintiff expected employment and participation in management); *In re* Topper, 107 Misc.2d 25, ____, 433 N.Y.S.2d 359, 365 (N.Y. Sup. Ct. 1980) (plaintiff expected employment and active management position).

36. 1 F. O'NEAL & R. THOMPSON, *supra* note 21, § 1:03; *see* Exadaktilos v. Cinnaminson Realty Co., 167 N.J. Super. 141, ____, 400 A.2d 554, 561 (N.J. Super. Ct. Law Div. 1979), *aff'd per curiam*, 173 N.J. Super. 559, 414 A.2d 994 (N.J. Super. Ct. App. Div. 1980) (shareholders generally expect that their return will be received in the form of salaries); *see also In re* Topper, 107 Misc.2d 25, ____, 433 N.Y.S.2d 359, 365 (N.Y. Sup. Ct. 1980) (shareholders' bargain includes salary). The earnings of a closely held corporation are generally paid in salaries to avoid the double taxation of dividends. 1 F. O'NEAL & R. THOMPSON, *supra* note 21, § 1:03.

37. Hetherington & Dooley, *supra* note 32, at 3. The authors note that many factors contribute to a breakdown of consensus in a close corporation. *Id.* For example, a change in the nature of the enterprise may render once valuable shareholder contributions irrelevant, or a shareholder may simply realize that her talents and capital can be invested more profitably elsewhere. *Id.*

38. *Id.*; *see* 1 F. O'NEAL & R. THOMPSON, *supra* note 21, §§ 2:02-07. O'Neal and Thompson discuss a variety of causes for strained shareholder relationships, including: greed, a desire for power, personality clashes, family quarrels, inactive shareholders, the death of a key shareholder, and the existence of an autocratic controlling shareholder. *Id.*

39. 309 N.C. 279, 307 S.E.2d 551 (1983); *see also* Note, *supra* note 30; Note, *A New Approach to Fulfilling Shareholders' Expectations in Close Corporations:* Meiselman v. Meiselman, 20 WAKE FOREST L. REV. 505 (1984).

related family corporations, with Ira Meiselman owning approximately seventy percent of the total shares of the family corporations and Michael Meiselman owning the remaining shares.[40] When Michael brought suit against Ira seeking dissolution of the family corporations, Ira responded by claiming that Michael suffered from crippling mental disorders.[41] In apparent support of his allegation, Ira related an argument that Michael had with their father in which their father castigated Michael for bringing a Gentile woman to a family function.[42] Ira testified to another fight that he and Michael had which stemmed from Ira's failure to invite Michael to a football game to which all the males in the family traditionally had been invited.[43] Needless to say, it is not surprising that Ira and Michael were incapable of carrying on the family business. While disagreements between shareholders may not always lead to allegations of mental infirmity, they can quickly lead to a falling out among the shareholders.

Once a falling out among the shareholders occurs, the minority shareholder in a closely held corporation has few options. Disagreements over corporate policy will be resolved in favor of the controlling shareholders.[44] The controlling shareholders' ownership of a majority of the stock and their resulting control of the board of directors enables them to control corporate decision making.[45] There is little that the minority shareholder can do. The dissatisfied shareholder in a publicly held corporation may withdraw her investment by selling her stock.[46] A dissatisfied

40. Meiselman v. Meiselman, 309 N.C. 279, ____, 307 S.E.2d 551, 553 (1983). Michael and Ira acquired ownership of the corporations from their parents through a series of gifts and bequests. *Id.* at ____, 307 S.E.2d at 553.

41. *Id.* at ____, 307 S.E.2d at 556. Michael contended that Ira had restricted Michael's access to corporate offices and information and excluded him from participating in corporate matters. *Id.* at ____, 307 S.E.2d at 555. Michael also contended that Ira acquired and sold corporate assets without his consent. *Id.* Ira countered by contending that Michael's limited participation was voluntary. *Id.*

42. *Id.* at ____, 307 S.E.2d at 556.

43. *Id.*

44. *See* Note, *supra* note 30, at 1004; *see also* 1 F. O'NEAL & R. THOMPSON, *supra* note 21, § 3:03. O'Neal contends that "[i]n the absence of some special control arrangement, set up by contract or special charter or bylaw provision, a corporation is subject to the principle of majority rule: holders of a majority of the voting shares govern." *Id.*

45. *See* Note, *supra* note 30, at 1004. The commentator contends that the minority shareholders will soon discover that the personal relationship and expectations of mutual decision making will be frustrated by the majority rule doctrine. *Id; see also* 1. F. O'NEIL & R. THOMPSON, *supra* note 21, § 1:02 (under the principle of majority rule, the holders of a majority of the shares with voting power control the corporation).

46. Olson, *supra* note 5, at 628; *see also* Donahue v. Rodd Electrotype Co., 367 Mass. 578, ____, 328 N.E.2d 505, 514 (1975) (oppressed stockholder in a public corporation can sell his stock to recoup his investment in contrast to a close corporation in which, by definition, no market is available for shares); Exadaktilos v. Cinnaminson Realty Co., 167 N.J. Super. 141, ____, 400 A.2d 554, 560 (N.J. Super. Ct. Law Div. 1979), *aff'd per curiam*, 173 N.J. Super. 559, 414 A.2d 994 (N.J. Super. Ct. App. Div. 1980) (although the marketplace usually provides a remedy for oppressed shareholders in a publicly held corporation, this remedy is not readily available to minority shareholders in a closely held corporation).

partner may dissolve a partnership.[47] Only in a closely held corporation may the shareholder find her investment locked in with little hope of freeing it.[48] Investors are seldom willing to purchase less than a controlling interest in a closely held corporation.[49] Nor will the controlling shareholders be inclined to purchase the interest of the minority shareholder. All the majority can gain by purchasing the minority shareholder's interest are those earnings attributable to her investment that they are unable to capture by manipulating their control position.[50] The minority shareholder can neither sell her interest to an outsider nor entice the controlling shareholders to purchase her interest at a fair value. The illiquidity of her investment puts her in a precarious situation.[51]

When dissatisfaction and dissension arise, the minority shareholder becomes vulnerable to freeze-outs.[52] Freeze-outs are actions taken by the controlling shareholders to deprive a minority shareholder of her interest in the business or a fair return on her investment.[53] A variety of freeze-out techniques exist,[54] with the

47. *See* Hetherington & Dooley, *supra* note 32, at 3; Olson, *supra* note 5, at 628; *see also* Donahue v. Rodd Electrotype Co., 367 Mass. 578, ____, 328 N.E.2d 505, 514 (1975) (in contrast to a partnership, an abused shareholder may not dissolve a corporation at will and recover his share of profits and assets).

48. *See* 1 F. O'NEIL & R. THOMPSON, *supra* note 21, § 1:03; Olson, *supra* note 5, at 628. O'Neal and Thompson explain the dilemma faced by a dissatisfied shareholder in a close corporation as follows:

> A dissatisfied shareholder cannot withdraw the funds he has invested, and he cannot find a purchaser for his interest. Seldom can anyone be found who is willing to buy a minority interest in a close corporation, especially if the company is divided by bitter disputes. A minority shareholder may have all or a substantial part of his capital invested in the company, and yet he cannot regain his capital without the consent of the very people with whom he is at loggerheads.

1 F. O'NEAL & R. THOMPSON, *supra* note 21, § 1:03, at 6; *see also* Donahue v. Rodd Electrotype Co., 367 Mass. 578, ____, 328 N.E.2d 505, 515 (1975) (no outsider would knowingly assume the position of the disadvantaged minority to encounter the same difficulties).

49. *See* 1 F. O'NEAL & R. THOMPSON, *supra* note 21, § 1:03; Hetherington & Dooley, *supra* note 32, at 5; *see also* Donahue v. Rodd Electrotype Co., 367 Mass. 578, ____, 328 N.E.2d 505, 515 (1975) ("freeze-out" schemes employed by the majority are designed to compel the minority to relinquish stock at inadequate prices).

50. Hetherington & Dooley, *supra* note 32, at 5. The authors contend that the majority may gain freedom from potential inconvenience or harassment on the part of the opposing minority by purchasing the minority's interest, if the majority attaches any value to those concerns. *Id.*

51. *Id.* at 6. The authors note that a close corporation is unique because it "subjects an owner to the dual hazards of a complete loss of liquidity and an indefinite exclusion from sharing in the profitability of the firm." *Id.; see also* Donahue v. Rodd Electrotype Co., 367 Mass. 578, ____, 328 N.E.2d 505, 513 (1975) (majority has won when minority is compelled to sell at less than a fair price).

52. *See* Donahue v. Rodd Electrotype Co., 367 Mass. 578, ____, 328 N.E.2d 505, 513 (1975); Note, *supra* note 30, at 1004-05, 1010. The term "squeeze-out," the term preferred by O'Neal and Thompson, is considered synonymous with the term "freeze-out." *See* 1 F. O'NEAL & R. THOMPSON, *supra* note 21, § 1:01 n.2. The term "freeze-out" is used in this Article.

53. Note, *supra* note 30, at 1005; *see also* Exadaktilos v. Cinnaminson Realty Co., 167 N.J. Super. 141, ____, 400 A.2d 554, 560 (N.J. Super. Ct. Law Div. 1979), *aff'd per curiam*, 173 N.J. Super. 559, 414 A.2d 994 (N.J. Super. Ct. App. Div. 1980); 2 F. O'NEAL, *supra* note 19, § 8.07. The economic consequences of freeze-outs are significant. *See* 1 F. O'NEAL & R. THOMPSON, *supra* note 21, § 1:04. O'Neal and Thompson contend that "[freeze-outs] and attempted [freeze-outs] undoubtedly bring to thousands of businesses each year friction and strife, impaired efficiency of managers, heavy loss of working hours by key personnel, expensive litigation, and diminished confidence in the business and its managers by banks, suppliers, customers and employees." *Id.* at 8.

54. *See* 1 F. O'NEAL & R. THOMPSON, *supra* note 21, §§ 3:02 to :20. There are numerous freeze-

withholding of dividends being by far the most commonly applied technique.[55] This technique is often combined with the discharge of the minority shareholder from employment and removal of the minority shareholder from the board of directors.[56] If the minority shareholder is employed by the corporation full time, as is typical, and if she relies on her salary as her primary means of obtaining a return on her investment, as is typical, she is suddenly left with little or no income and little or no return on her investment.[57] The controlling shareholders may effectively deprive the minority shareholder of every economic benefit that she derives from the corporation.[58] Meanwhile, the controlling shareholders may continue to receive a substantial return based on their continuing employment with the corporation. The minority shareholder's investment serves only to ensure the success of the corporation for the benefit of the controlling shareholders.[59]

Examples of such behavior on the part of controlling shareholders are common.[60] A review of one such case provides a flavor of the type of activity that may exist. In *Wilkes v. Springside Nursing Home, Inc.*[61] four investors formed a corporation to operate a nursing home.[62] Each of the parties invested the same amount of money with the understanding that each would be a director and

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out techniques that controlling shareholders may use to oppress a minority shareholder, including: withholding dividends, excluding a minority shareholder from employment, paying themselves excessively high compensation for services rendered, withholding information, usurping corporate opportunities, siphoning off corporate earnings by leases and loans favorable to themselves, and having the corporation purchase their shares at a high price. *Id.*

55. 1 F. O'NEAL & R. THOMPSON, *supra* note 21, § 3:04; Note, *supra* note 30, at 1005. O'Neal and Thompson state that the withholding of dividends is frequently used because it is easily applied and generally exerts great pressure on minority shareholders to sell their shares. 1 F. O'NEAL & R. THOMPSON, *supra* note 21, § 3:04. The withholding of dividends is often used when the minority shareholder is dependent upon income from dividends and is in financial straits. *Id.*

56. 1 F. O'NEAL & R. THOMPSON, *supra* note 21, §§ 3:04, :06; *see* Wilkes V. Springside Nursing Home, Inc., 370 Mass. 842, ____, 353 N.E.2d 657, 662 (1976) (effective freeze-out technique is to deprive minority shareholder of employment); Note, *supra* note 30, at 1005 (controlling shareholder will ordinarily fire minority shareholder).

57. *See* 1 F. O'NEAL & R. THOMPSON, *supra* note 21, § 1:03; Olson, *supra* note 5, at 628; *see also* Donahue v. Rodd Electrotype Co., 367 Mass. 578, ____, 328 N.E.2d 505, 514 (1975) (minority stockholder typically invests a substantial portion of his personal assets in the corporation and anticipates that his salary will be his livelihood).

58. Note, *supra* note 30, at 1005. One student of corporate law notes that in a freeze-out by the controlling group, the majority will ordinarily fire the minority shareholder and cut her off from any return on her investment. *Id.* Thus, the minority shareholder will hope to withdraw from the corporation with her investment and may consider involuntary dissolution as the only available recourse. *Id.*

59. *See* Hetherington & Dooley, *supra* note 32, at 5-6; Olson, *supra* note 5, at 628.

60. *See, e.g.*, Alaska Plastics, Inc. v. Coppock, 621 P.2d 270 (Alaska 1980); Donahue v. Rodd Electrotype Co., 367 Mass. 578, 328 N.E.2d 505 (1975); *In re* Topper, 107 Misc.2d 25, 433 N.Y.S.2d 359 (N.Y. Sup. Ct. 1980).

61. 370 Mass. 842, 353 N.E.2d 657 (1976).

62. Wilkes v. Springside Nursing Home, Inc., 370 Mass. 842, ____, 353 N.E.2d 657, 659 (1976). Wilkes acquired an option to purchase a lot and building that had previously housed a hospital. *Id.* Riche, an acquaintance of Wilkes, persuaded Pipkin and Quinn to join in Wilkes' investment. *Id.* The parties subsequently decided that the property would be most profitable if it was operated as a nursing home. *Id.*

that each would participate in the management and operation of the corporation.[63] The parties also understood that each would receive money from the corporation in equal amounts as long as each assumed an active and continuing responsibility for the business.[64]

A dispute developed between two of the shareholders, Quinn and Wilkes, over the sale of some property.[65] The two other shareholders sided with Quinn.[66] As a consequence of the dispute, the board of directors terminated Wilkes' salary and increased Quinn's compensation.[67] At the next meeting of the shareholders, Wilkes failed to win reelection as either a director or officer of the corporation.[68] The other shareholders informed Wilkes that neither his services nor his presence at the nursing home was desired.[69] The court noted that the acts of the other shareholders were taken because of their personal desire to prevent Wilkes from receiving income from the corporation.[70] Because the corporation had never paid dividends, Wilkes' salary had been his only source of return on his investment.[71] Because of these actions, Wilkes brought suit against the corporation and its shareholders.[72]

When a minority shareholder is confronted with a situation like the one in *Wilkes*, she has little choice but to bring suit in an

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63. *Id.* at ____, 353 N.E.2d at 659-60.

64. *Id.* at ____, 353 N.E.2d at 660.

65. *Id.* The animosity between the shareholders started when they decided to sell a portion of the corporate property to Quinn. *Id.* Quinn not only held stock in the nursing home, but also possessed an interest in another corporation that hoped to operate a rest home on the property. *Id.* Wilkes succeeded in convincing the other shareholders to procure a higher sale price for the property than Quinn anticipated or desired to pay. *Id.* After the sale was completed, the relationship between Quinn and Wilkes deteriorated, which also affected the attitudes of the other stockholders. *Id.* Because of the strained relations among the parties, Wilkes gave notice of his intention to sell his shares based upon their appraised values. *Id.* at ____, 353 N.E.2d at 660-61.

66. *Id.* at 661.

67. *Id.* The board of directors held a meeting and established the salaries of its officers and directors. *Id.* A schedule of payments was established, with Quinn to receive a substantial increase in salary and the other two stockholders to continue to receive their normal weekly salary. *Id.*

68. *Id.*

69. *Id.*

70. *Id.*

71. *Id.* The directors and shareholders held meetings for the purpose of forcing Wilkes out of active participation in the management and operation of the corporation and to cut him off from all corporate payments. *Id.* Although the board had the power to dismiss officers for misconduct or neglect of duties, Wilkes' dismissal was not based on either of these grounds. *Id.* Rather, Wilkes was dismissed solely because the other stockholders desired to freeze him out. *Id.* There was evidence that despite the strained personal relationship with the other stockholders, Wilkes continued to perform his responsibilities to the corporation in a satisfactory and competent manner. *Id.* at ____, 353 N.E.2d at 661, 664.

72. *Id.* at ____, 353 N.E.2d at 659. Wilkes sought damages based on the amount of salary he would have received from his positions as officer and director had it not been for the freeze-out. *Id.* Wilkes also sought damages from the majority shareholders for breach of their fiduciary duty. *Id.* The court reached the "inescapable conclusion" that the action of the majority was a designed "freeze-out" with no legitimate business purpose. *Id.* at ____, 353 N.E.2d at 664. The court held that the majority shareholders had breached their fiduciary duty to Wilkes as a minority shareholder and ordered damages against the majority for the amount of salary Wilkes would have received had he remained an officer and director of the corporation. *Id.* at ____, 353 N.E.2d at 664-65.

attempt to obtain some sort of remedy. Ordinarily, neither the articles of incorporation nor the bylaws of the corporation will provide relief. A shareholder agreement, if one exists, is rarely applicable.[73] While the controlling shareholders may offer to purchase the minority shareholder's stock, the offer invariably values the stock at less than a fair price.[74] The freeze-out effectively eliminates the minority shareholder from the corporation and leaves her with nothing more than a lawsuit.[75]

III. THE INTERVENTION FRAMEWORK

The intervention framework is based upon decisions in which courts have intervened to protect the rights of a minority shareholder. Courts have used a variety of justifications to reach decisions that prevent controlling shareholders from engaging in freeze-out activities.[76] Regardless of the particular justification employed, courts operating within the intervention framework ensure that those in control act fairly. Controlling shareholders are not allowed to take actions that prevent the minority shareholder from obtaining a return on her investment. The courts stand ready to intervene to set things right.

A. INTERVENTION IN THE ABSENCE OF STATUTORY AUTHORITY

The general rule at common law was that, absent statutory authority, courts had no jurisdiction to grant a dissolution at the request of a minority shareholder.[77] Despite the general rule, a number of courts acknowledged their equitable power to dissolve a corporation and protect a minority shareholder.[78] In *Miner v. Belle*

73. *See* O'Neal, *supra* note 31, at 883-84 (shareholder agreements rarely anticipate disagreements or contain protective arrangements).

74. *See* Donahue v. Rodd Electrotype Co., 367 Mass. 578, ____, 328 N.E.2d 505, 515 (1975) ("freeze-out" schemes are designed to compel the minority to relinquish stock at inadequate prices); Note, *supra* note 35, at 1121.

75. *See* Note, *supra* note 30, at 1005 (in a freeze-out the majority shareholders attempt to deprive the minority shareholder of every benefit derived from the corporation); Note, *supra* note 35, at 1122-23 (filing for involuntary dissolution may be minority shareholder's only protection against mistreatment by the majority).

76. One justification for preventing freeze-out activities is that the controlling shareholders have operated the corporation for their own benefit. *See infra* text accompanying notes 80-83. A second justification is that the controlling shareholders have oppressed the minority shareholder. *See infra* text accompanying notes 88-101. A third justification is that the controlling shareholders breached their fiduciary duty to the minority shareholder. *See infra* text accompanying notes 102-121. A final justification is that the controlling shareholders frustrated the reasonable expectations of the minority shareholder. *See infra* text accompanying notes 122-149.

77. *See* Rowland v. Rowland, 102 Idaho 534, ____, 633 P.2d 599, 605 (1981); Fix v. Fix Material Co., 538 S.W.2d 351, 357 (Mo. Ct. App. 1976); Note, *supra* note 35, at 1125.

78. *See, e.g.*, Ross v. American Banana Co., 150 Ala. 268, ____, 43 So. 817, 817 (1907) (shareholder had cause of action for dissolution when failure of corporate purpose had occurred); Graham v. McAdoo, 135 Ky. 677, ____, 123 S.W. 260, 262 (1909) (dissolution proper when

Isle Ice Co.[79] the Michigan Supreme Court provided a precedent for courts that wished to intervene, notwithstanding an absence of statutory authority. In *Miner* a minority shareholder complained that the controlling shareholder refused to pay dividends, paid himself an excessive salary as the president and manager of the corporation, and generally operated the corporation solely for his own personal benefit.[80] The court concluded that a court of equity has the power to dissolve a corporation when a controlling shareholder uses his control to operate the corporation for his own benefit and causes a loss to the minority shareholder.[81] The court reasoned that a corporation has a duty to dissolve itself when it has failed to fulfill the purposes for which it was created.[82]

A number of courts followed the lead of the *Miner* decision.[83] In fact, it is now claimed that the general common-law rule is that courts of equity possess an inherent power to protect a minority shareholder from oppressive or abusive conduct.[84] As a result, intervention absent statutory authority has become justified when the controlling shareholders have engaged in certain behavior. The framework thus protects minority shareholders.

B. STATUTORY GROUNDS FOR RELIEF - THE OPPRESSION ANALYSIS

Mistreatment of minority shareholders first became a statutory ground for relief in 1933 when the Illinois Legislature adopted fraudulent, illegal, or oppressive activity as grounds for relief.[85] The Illinois legislation served as an example for other

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corporate ruin is inevitable due to mismanagement); Ponca Mill Co. v. Mikesell, 55 Neb. 98, 101-02, 75 N.W. 46, 48 (1898) (gross mismanagement and misappropriation of corporate property justifies dissolution).

79. 93 Mich. 97, 53 N.W. 218 (1892).

80. *See* Miner v. Bell Isle Ice Co., 93 Mich. 97, 98-108, 53 N.W. 218, 218-21 (1892).

81. *See id.* at 117, 53 N.W. at 224.

82. *Id.* at 112-13, 53 N.W. at 223. The court acknowledged that the general rule was that courts had no power to dissolve a corporation absent statutory authority, but recognized exceptions to that rule. *Id.* at 112, 53 N.W. at 223. The court noted that the ultimate objective of every business corporation is the pecuniary gain of its shareholders and that this is the only reason capital has been advanced. *Id.* at 113, 53 N.W. at 223. If circumstances render it impossible to continue making profits for the shareholders, it is the duty of the management of the corporation to wind up its affairs. *Id.*

83. *See supra* note 78; *see also* Bellevue Gardens, Inc. v. Hill, 297 F.2d 185 (D.C. Cir. 1961); Levant v. Kowal, 350 Mich. 232, 86 N.W.2d 336 (1957); Leibert v. Clapp, 13 N.Y.2d 313, 196 N.E.2d 540, 247 N.Y.S.2d 102 (1963).

84. *See* Note, *supra* note 39, at 515; Note, *supra* note 35, at 1125. Just as exceptions to the former common-law rule existed, exceptions to the current common-law rule also exist. *See* Note, *supra* note 35, at 1125-26 (courts will not grant dissolution when controlling group advances best interests and purpose of corporation in good faith). The fact that exceptions exist to both the former and current common-law rules reflects the folly of claiming the existence of a general common-law rule.

85. The Business Corporation Act of 1933, § 86(a)(2), 1933 Ill. Laws 308, 351 (repealed 1984) (current version at ILL. ANN. STAT. ch. 32, § 12.50(b)(2) (Smith-Hurd Supp. 1986)).

states. A majority of states now have statutes that allow liquidation or dissolution upon proof that the controlling shareholders acted in an illegal, fraudulent, or oppressive manner.[86]

To obtain relief on such grounds, minority shareholders invariably asserted that the actions of the controlling shareholders were oppressive.[87] When courts wished to protect the minority shareholders, the courts characterized the acts of the controlling shareholders in such a manner as to bring the acts within the definition of oppression.[88] For example, in *Gidwitz v. Lanzit Corrugated Box Co.*[89] shareholders brought an action against the controlling shareholders alleging, among other things, that the controlling shareholders had committed illegal, fraudulent, and oppressive acts.[90] During a ten year period, the controlling shareholders held no annual shareholder meetings.[91] The president, a member of the controlling shareholder group, essentially operated and managed the corporation as a sole proprietorship.[92] In reviewing the acts of the controlling shareholders, the court was quick to note that oppressive behavior was not synonymous with illegal or fraudulent behavior.[93] In language recalling the equitable standard established by *Miner*, the court held that the controlling shareholders had operated the corporation for their own benefit, thereby depriving the other

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86. *See, e.g.*, ALA. CODE § 10-2A-195(a)(1)(b) (1980); ALASKA STAT. § 10.05.540(2) (1985); ARK. STAT. ANN. § 64-908(A)(2) (1980); COLO. REV. STAT. § 7-8-113(2)(a) (Supp. 1985); IDAHO CODE § 30-1-97(a)(2) (1980); IOWA CODE ANN. § 496A.94(1)(c) (West Supp. 1985); MD. CORPS. & ASS'NS CODE ANN. § 3-413(b)(2) (1985); MISS. CODE ANN. § 79-3-193(a)(2) (1972); MO. ANN. STAT. § 351.485 (1)(1)(b) (Vernon 1966); MONT. CODE ANN. § 35-2-711 (a)(ii) (1985); NEB. REV. STAT. § 21-2096(1)(b) (1983); N.M. STAT. ANN. § 53-16-16(A)(1)(b) (1983); OR. REV. STAT. § 57.595(1)(a)(B) (1985); PA. STAT. ANN. tit. 15, § 2107 (A)(2) (Purdon 1967); R.I. GEN. LAWS § 7-1.1-90(a)(1)(B) (1985); S.D. CODIFIED LAWS ANN. § 47-7-34(2) (1983); TENN. CODE ANN. § 48-1-1008(a)(1)(C) (1984); UTAH CODE ANN. § 16-10-92(a)(2) (Supp. 1985); VT. STAT. ANN. tit. 11, § 2067(a)(1)(B) (1984); VA. CODE § 13.1-747(A)(1)(b) (1985); WASH. REV. CODE ANN. § 23A.28.170(1)(b) (1969); W. VA. CODE § 31-1-41(a)(2) (1982); WYO. STAT. § 17.1-1-614(a)(i)(B) (Supp. 1985).

87. *See, e.g.*, Coduti v. Hellwig, 127 Ill. App. 3d 279, ____, 469 N.E.2d 220, 225 (1984); Fix v. Fix Material Co., 538 S.W.2d 351, 357 (Mo. Ct. App. 1976).

88. *See, e.g.*, Gidwitz v. Lanzit Corrugated Box Co., 20 Ill. 2d 208, 170 N.E.2d 131 (1960).

89. 20 Ill. 2d 208, 170 N.E.2d 131 (1960).

90. Gidwitz v. Lanzit Corrugated Box Co., 20 Ill. 2d 208, 212, 170 N.E.2d 131, 133 (1960). In *Gidwitz*, the stock of the corporation was split 50-50 between two dissident families. *Id.* at 215, 170 N.E.2d at 135. One group, the Gidwitz faction, was able to completely control and manage the corporation to the exclusion of the other shareholder group by virtue of Joseph Gidwitz's position as president and chief executive officer of the corporation. *Id.* at 215, 170 N.E.2d at 135-36.

91. *Id.* at 215, 170 N.E.2d at 136. The court noted that the failure to hold annual shareholder meetings effectively deprived the plaintiff group of their right to vote for directors of the corporation. *Id.* at 216, 170 N.E.2d at 136.

92. *See id.* The court noted that the voting power was evenly split between the directors of the corporation. *Id.* Because of an irreconcilable split in all matters pertaining to management of the corporation, Joseph Gidwitz, as president, could effectively control the operation and management of the corporation regardless of the views of the other half of the shareholders and directors. *Id.* Joseph did this by avoiding shareholder and director meetings and failing to call to the attention of the other directors or shareholders anything that could affect his control or management. *Id.* at 217, 170 N.E.2d at 137.

93. *Id.* at 215, 170 N.E.2d at 135.

shareholders of their rights and privileges.[94] Because the controlling shareholders' behavior constituted oppressive conduct for which the future held little hope of abatement, dissolution was justified.[95]

While it was clear that the existence of controlling shareholders operating the corporation for their own benefit was a sufficient basis to justify relief under the oppression standard, the sufficiency of other conduct justifying relief was unclear.[96] Instead of relying on the rather limited definition of oppression developed by Illinois decisions,[97] a number of courts looked elsewhere for a more comprehensive perspective.[98] Oppression became viewed as "'burdensome, harsh and wrongful conduct,' 'a lack of probity and fair dealing in the affairs of a company to the prejudice of some of its members,' or 'a visible departure from the standards of fair dealing, and a violation of fair play on which every shareholder who entrusts his money to a company is entitled to rely.'"[99] This broader definition justified the intervention of a number of courts to protect the interests of minority shareholders.[100] It was a rather simple matter for courts to characterize acts as a violation of fair play.

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94. *Id.* at 216, 170 N.E.2d at 136. The court stated that "[t]he essential attribute of a shareholder in a corporation is that he is entitled to participate, according to the amount of his stock, in the selection of the management of the corporation, and he cannot be deprived or deprive himself of that power." *Id.* at 215, 170 N.E.2d at 135. The court noted a continuing course of conduct on the part of Joseph Gidwitz and the controlling group to exclude the plaintiffs from participating in the management of the corporation. *Id.* at 216, 170 N.E.2d at 136. In addition, Joseph refused to follow the corporate bylaws or subordinate his actions or advice to the board of directors. *Id.*

95. *Id.* at 221, 170 N.E.2d at 138.

96. *See, e.g.*, Gidwitz v. Lanzit Corrugated Box Co., 20 Ill. 2d 208, 170 N.E.2d 131 (1960). In *Gidwitz* the court defined oppression by discussing what oppression was not, rather than what it was. *See id.* at 214-15, 170 N.E.2d at 135. The court stated as follows:

> We have held that the word "oppressive" as used in this statute, does not carry an essential inference of imminent disaster . . . . The word does not necessarily savor of fraud, and the absence of "mismanagement, or misapplication of assets," does not prevent a finding that the conduct of the dominant directors or officers has been oppressive. It is not synonymous with "illegal" and "fraudulent."

Id.

97. For a discussion of the Illinois definition of oppression, see *supra* note 96. *See also* Central Standard Life Ins. Co. v. Davis, 10 Ill. 2d 566, 573-74, 141 N.E.2d 45, 50 (1957).

98. British cases construing the oppression standard of section 210 of the British Company Act of 1948 provided a broader perspective. *See* Companies Act, 1948, 11 & 12 Geo. 6, ch. 38, § 210, *repealed by* Companies Act, 1980, ch. 22, § 88(2), Sched. 4; Companies Act, 1980, ch. 22, § 75(II) (current version at Companies Act, 1985; *see, e.g.*, Scottish Co-op. Wholesale Soc'y, Ltd. v. Meyer, [1958] 3 All E.R. 66, 71, 86 (H.L.); Elder v. Elder & Watson, Ltd., [1952] Sess. Cas. 49, 55.

99. Comment, *Oppression as a Statutory Ground for Corporate Dissolution,* 1965 DUKE L.J. 128, 134 (footnotes omitted) (quoting Scottish Co-op. Wholesale Soc'y, Ltd. v. Meyer, [1958] 3 All E.R. 66, 71 (H.L.); Elder v. Elder & Watson, Ltd., [1952] Sess. Cas. 49, 55) (*quoted in* Baker v. Commercial Body Builders, Inc., 264 Or. 614, ____, 507 P.2d 387, 393 (1973)); *see also* Fix v. Fix Material Co., 538 S.W.2d 351, 358 (Mo. Ct. App. 1976); White v. Perkins, 213 Va. 129, ____, 189 S.E.2d 315, 319-20 (1982). This broader definition of oppression was based on earlier British decisions. *See supra* note 98.

100. *See, e.g.*, Skierka v. Skierka Bros., 629 P.2d 214, 200-222 (Mont. 1981); White v. Perkins, 213 Va. 129, ____, 189 S.E.2d 315, 320 (1982).

1. *Concept of an Enhanced Fiduciary Duty*

The comprehensive definition of oppression used by some courts provided a basis for relief. Certain refinements in its application, however, created further justification for a court's intervention and significantly increased the power of the intervention framework. Oppression became a more attractive avenue for relief when it was combined with the notion of the controlling shareholders' fiduciary duty. Courts began to acknowledge that if the controlling shareholders breached their fiduciary duty to the minority shareholders, oppression resulted.[101]

The duty owed to minority shareholders was described in the landmark decision of *Donahue v. Rodd Electrotype Co.*[102] In *Donahue* the plaintiff was a minority shareholder in a closely held corporation.[103] As part of the retirement plan of Henry Rodd, the founder of the corporation, the Rodd family caused the corporation to purchase his forty-five shares.[104]

The purchase of Henry Rodd's shares took place without the plaintiff's knowledge.[105] Upon learning of the transaction, the plaintiff brought her shares to the corporation for purchase on the same terms given Henry Rodd.[106] The corporation refused to purchase the plaintiff's shares.[107] The plaintiff then brought an action alleging that the controlling shareholders had breached their fiduciary duty to her as a minority shareholder by causing the corporation to purchase the stock of Henry Rodd without offering the same opportunity to her.[108] The Massachusetts Supreme Judicial Court agreed, holding that when controlling shareholders use their position to confer benefits upon themselves, they must offer the same benefits to the minority shareholders.[109] The Rodd

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101. *See* Fix v. Fix Material Co., 538 S.W.2d 351, 358 (Mo. Ct. App. 1976) (fiduciary concepts are used in measuring conduct of controlling shareholders, particularly in closely held corporations); Baker v. Commercial Body Builders, Inc., 264 Or. 614, ____, 507 P.2d 387, 394 (1973) ("oppressive" conduct is closely related to the fiduciary duty of good faith and fair dealing owed to minority shareholders).

102. 367 Mass. 578, 328 N.E.2d 505 (1975).

103. Donahue v. Rodd Electrotype Co., 367 Mass. 578, ____, 328 N.E.2d 505, 519 (1975). The plaintiff held 50 shares of stock in the closely held corporation with the remaining 198 shares held by the Rodd family. *Id.* at ____, 328 N.E.2d at 510.

104. *Id.* The purchase price of Henry Rodd's shares was set at book and liquidation value. *Id.*

105. *Id.* The trial court found that upon learning of the repurchase, the plaintiff did not ratify the purchase of Henry Rodd's shares. *Id.* at ____, 328 N.E.2d at 511.

106. *Id.*

107. *Id.*

108. *Id.* The trial court approved the transaction in which the corporation repurchased Henry Rodd's stock, finding that the transaction was fair to the corporation and carried out in good faith. *Id.* at ____, 328 N.E.2d at 508.

109. *Id.* at ____, 328 N.E.2d at 519. The court held that the controlling group may not, in violation of their strict fiduciary duty, establish an exclusive market in previously unmarketable shares if the minority shareholders are excluded from the market. *Id.* at ____, 328 N.E.2d at 518. In

family's failure to extend the opportunity for purchase to the plaintiff constituted a breach of their fiduciary duty.[110]

The court's analysis of the duty existing between controlling shareholders and minority shareholders in a closely held corporation broke new ground.[111] The court imposed a standard of duty equal to the duty existing between partners in a partnership, which was defined "'as the 'utmost good faith and loyalty.'"[112] The court explicitly contrasted this standard with the less stringent standard that directors and shareholders of all corporations must adhere to in the discharge of their corporate responsibilities.[113]

The court believed that the imposition of an enhanced fiduciary duty was warranted because of the nature of closely held corporations.[114] First, the court noted that closely held corporations resemble partnerships.[115] Just as in a partnership, the relationship among the shareholders of a closely held corporation must be one of trust, confidence, and absolute loyalty if the business is to succeed.[116] Second, the court acknowledged the minority shareholders' great vulnerability to abuse by the controlling shareholders.[117] The power of the directors, dominated by the controlling shareholders, to declare or withhold dividends or to deny or terminate employment is easily converted into a device of oppression.[118] Finally, the court recognized the problems of

addition, the court noted that the majority's purchase also distributed corporate assets to the shareholder whose shares were purchased. *Id.* The court determined that the purchase of shares from one member of the controlling group is a "preferential distribution of assets" unless an equal opportunity is given to all stockholders. *Id.* at ____, 328 N.E.2d at 518-19 (emphasis omitted). Consequently, the court held that "in any case in which the controlling stockholders have exercised their power over the corporation to deny the minority such equal opportunity, the minority shall be entitled to appropriate relief." *Id.* at ____, 328 N.E.2d at 519.

110. *Id.* at ____, 328 N.E.2d at 520.

111. *See* Comment, *The Strict Good Faith Standard — Fiduciary Duties to Minority Shareholders in Close Corporations,* 33 MERCER L. REV. 595, 599 (1982). *See generally* Bulloch, *Heightened Fiduciary Duties in Closely Held Corporations:* Donahue *Revisited,* 16 PAC. L.J. 935 (1985) (discussion of how *Donahue* changed the law applicable to close corporations).

112. Donahue v. Rodd Electrotype Co., 367 Mass. at ____, 328 N.E.2d at 515 (citations omitted). The court described the duty imposed upon stockholders in a close corporation as follows:

> [S]tockholders in the close corporation owe one another substantially the same fiduciary duty in the operation of the enterprise that partners owe to one another. . . . [W]e have defined the standard of duty owed by partners to one another as the "utmost good faith and loyalty." Stockholders in close corporations must discharge their management and stockholder responsibilities in conformity with this strict good faith standard. They may not act out of avarice, expediency or self-interest in derogation of their duty of loyalty to the other stockholders and to the corporation.

Id. (citations omitted).

113. *Id.* at ____, 328 N.E.2d at 515-16. The court stated that directors of general corporations are held only to a good faith and inherent fairness standard of conduct. *Id.*

114. *Id.* at ____, 328 N.E.2d at 512.

115. *Id.*

116. *Id.; see supra* note 29; Comment, *supra* note 111, at 600.

117. Donahue v. Rodd Electrotype Co., 367 Mass. at ____, 328 N.E.2d at 513. The court noted that the majority may employ a variety of oppressive "freeze-out" devices to which the minority is vulnerable. *Id.*

118. *Id.* For a discussion of freeze-out techniques employed by controlling groups, see *supra*

illiquidity that a minority shareholder faces.[119] The minority shareholder simply does not have the ability to dispose of her stock in the marketplace.[120]

Holding controlling shareholders to a standard of strictest good faith expands the realm of activity that may be characterized as oppressive.[121] A violation of the controlling shareholders' fiduciary duty allows a minority shareholder to bring a claim of oppression against the controlling shareholders. Under this analysis, a minority shareholder need only claim that the controlling shareholders failed to exercise utmost good faith and loyalty.

2. *Reasonable Expectations Approach*

A further refinement of the oppression analysis came about when courts began to interject the idea of reasonable expectations.[122] The reasonable expectations approach attempts to protect a minority shareholder's reasonable expectations of her role in, and return from, the closely held corporation. The controlling shareholders frustration of the reasonable expectations of a minority shareholder may constitute oppression. If it is the shareholders' intention that all shareholders actively participate in the management of the corporation, for example, the exclusion from participation of one of the shareholders may be oppressive.[123]

The reasonable expectations analysis has been justified by the highly personal relationships that generally exist between the shareholders in closely held corporations.[124] Such relationships suggest that the shareholders in a closely held corporation have certain reasonable expectations at the inception of the enterprise. These expectations typically include participation in management and employment with the corporation.[125] Under this analysis, a shareholder has a right to obtain relief when she has been

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notes 52-59 and accompanying text. *See also* Bulloch, *supra* note 111, at 939-40; Comment, *supra* note 111, at 600.

119. Donahue v. Rodd Electrotype Co., 367 Mass. at ____, 328 N.E.2d at 514.

120. *Id.* For a discussion of the plight of minority shareholders in close corporations, see *supra* notes 48-51 and accompanying text. *See also* Bulloch, *supra* note 111, at 938-39 (no informed person would purchase a minority shareholder's stock in a close corporation when strained relationships exist between minority and majority shareholders).

121. *See* Bulloch, *supra* note 111, at 935.

122. *See* O'Neal, *supra* note 31, at 885. O'Neal defines the reasonable expectations of a shareholder as the "expectation to participate in management or to be employed by the company." *Id.*

123. *See id.* at 885-88.

124. *See id.* at 885-86; Peeples, *supra* note 20, at 501.

125. *See* O'Neal, *supra* note 31, at 884-85; Peeples, *supra* note 20, at 501-02; Note, *supra* note 30, at 1010.

unexpectedly denied future employment and faces a future of little or no return from an investment which she expected to support her.[126] Consideration of the reasonable expectations of a minority shareholder may shift the court's examination away from the conduct of the controlling shareholders because such conduct is arguably irrelevant if a minority shareholder's reasonable expectations have been frustrated.[127] Because of its emphasis on the expectations of the shareholders, some commentators have argued that the reasonable expectations approach constitutes the most reliable guide to a just solution of disputes between the shareholders in a closely held corporation.[128]

In re Topper[129] represents one of the first decisions to incorporate the reasonable expectations approach to oppression. In *Topper* three individuals formed two corporations; each corporation was to operate a separate pharmacy.[130] Each of the individuals had a one-third interest in both corporations.[131] The petitioner expected to become actively involved in the management of the business.[132] Relying upon his expectations, he terminated his employment of twenty-five years, moved his family from Florida to New York, and invested his life's savings in the venture.[133]

Less than a year after formation of the corporations, the other two shareholders discharged the petitioner as an employee, terminated his salary, and removed him from his position as a corporate officer.[134] Because no dividends were being paid, the petitioner was effectively precluded from obtaining any return on his investment.[135] The petitioner filed for dissolution, charging that the controlling shareholders had engaged in oppressive conduct.[136]

The court concluded that the acts of the controlling

126. *See* O'Neal, *supra* note 31, at 887.

127. *See* Note, *supra* note 30, at 1011; Note, *supra* note 39, at 533. One student of corporate law has noted that the reasonable expectations test primarily focuses on the impact upon the minority shareholders and disregards the oppressive acts of the majority. Note, *supra* note 30, at 1011. This approach justifies relief even when the acts of the majority are not wrongful. *Id.*

128. *See* O'Neal, *supra* note 31, at 886 (reasonable expectations of shareholders may be the most reliable guide in resolving disputes because the close corporation's charter and bylaws seldom reflect the full business bargain); Peeples, *supra* note 20, at 501 (the reasonable expectations of shareholders assume great significance because they "represent the understanding and assumptions that initially induced the parties to combine efforts").

129. 107 Misc. 2d 25, 433 N.Y.S.2d 359 (N.Y. Sup. Ct. 1980).

130. *In re* Topper, 107 Misc. 2d 25, ____, 433 N.Y.S.2d 359, 361 (N.Y. Sup. Ct. 1980).

131. *Id.* at ____, 433 N.Y.S.2d at 362.

132. *Id.* at ____, 433 N.Y.S.2d at 361.

133. *Id.* at ____, 433 N.Y.S.2d at 361-62. In addition to his investment the petitioner also executed personal guarantees and promissory notes for his stock interest. *Id.*

134. *Id.* at ____, 433 N.Y.S.2d at 362. The other shareholders admitted that the petitioner was the most active member in the corporation. *Id.*

135. *Id.*

136. *Id.* at ____, 433 N.Y.S.2d at 361. In addition to asking the court for dissolution, the petitioner, in the alternative, asked the court to direct the two controlling shareholders to buy-out his shares at fair market value. *Id.*

shareholders were oppressive because they severely damaged the petitioner's reasonable expectations and froze-out his interest in the corporations.[137] The court spent little time dismissing the controlling shareholders' claim that the discharge was justified.[138] The court deemed irrelevant the possibility that the discharge may have been for cause or the result of a valid exercise of business judgment.[139]

The court's analysis in *Topper* has led to a number of decisions justifying intervention on the basis of a minority shareholder's reasonable expectations.[140] Subsequent decisions have noted that oppression arises when the controlling shareholders' conduct substantially defeats a minority shareholder's expectations that, objectively viewed, were both reasonable under the circumstances and central to the minority shareholder's decision to join the venture.[141]

While only a limited number of courts have used the reasonable expectations approach, several generalizations can be made.[142] First, the expectations of all parties are relevant, not just the expectations of the minority shareholder.[143] Second, a shareholder's expectations will be honored only if they were disclosed to the other parties, secret expectations are unenforceable.[144] Third, a shareholder's expectations may include employment and management participation.[145] Finally, expectations may change over the life of the enterprise because

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137. *Id.* at ____, 433 N.Y.S.2d at 362.

138. *Id.* The controlling shareholders argued that the petitioner had suffered no harm because his one-third interest in each of the two corporations remained intact and that the discharge of petitioner was justified. *Id.*

139. *Id.* The court in *Topper* used the following language to explain why the majority shareholders' conduct was oppressive:

> Whether the controlling shareholders discharged petitioner for cause or in their good business judgment is irrelevant. The court finds that the undisputed understanding of the parties was such at the time of the formation of the corporation that the respondents' actions have severely damaged petitioner's reasonable expectations and constitute a freeze-out of petitioner's interest; consequently, they are deemed to be "oppressive" within the statutory framework.

Id.

140. *See, e.g., In re* Kemp & Beatley, Inc., 64 N.Y.2d 63, 473 N.E.2d 1173, 484 N.Y.S.2d 799 (1984); *In re* Taines, 111 Misc. 2d 559, 444 N.Y.S.2d 540 (N.Y. Sup. Ct. 1981).

141. *See, e.g., In re* Wiedy's Furniture Clearance Center, 108 A.D. 2d 81, ____, 487 N.Y.S.2d 901, 903 (1985).

142. Peeples, *supra* note 20, at 502.

143. *See id.; see also* Exadaktilos v. Cinnaminson Realty Co., 167 N.J. Super. 141, 154-55, 400 A.2d 554, 561-62 (N.J. Super. Ct. Law Div. 1979), *aff'd per curiam,* 173 N.J. Super. 559, 414 A.2d 994 (N.J. Super. Ct. App. Div. 1980).

144. Peeples, *supra* note 20, at 502.

145. *Id.* at 502-03; *see supra* notes 35-36, 125.

expectations at the inception of the business may not be the expectations of the shareholders at a later date.[146]

The reasonable expectations approach to oppression allows a court to apply a standard that has no reference to the actions of the controlling shareholders.[147] The acts of the controlling shareholders may be both reasonable and made in good faith, but if the acts frustrate a shareholder's reasonable expectations, oppression and a right to relief exist.[148] The focus is shifted away from the activities of the controlling shareholders to the effect of those activities upon the minority shareholder's reasonable expectations. While such a shift may be subtle, it has important ramifications.[149]

C. STATUTORY GROUNDS FOR RELIEF — RIGHTS AND INTERESTS

In addition to the oppression analysis, a final basis upon which to justify intervention focuses on the rights and interests of the minority shareholder.[150] This basis for relief is found in California and North Carolina statutes, that provide for dissolution or other remedies upon a showing that relief is "reasonably necessary for the protection of the rights or interests of the complaining shareholder."[151] The few cases that have addressed these statutes suggest that they provide broad relief to a minority shareholder.[152] The fact that no reference to the misconduct of the controlling shareholder is required removes a significant obstacle for the dissatisfied shareholder.[153] These statutes lead to an analysis that is remarkably similar to the reasonable expectations approach to oppression. Under both approaches, courts may look at how the acts of the controlling

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146. Peeples, *supra* note 20, at 503.

147. *Id.* at 504. Peeples contends that the lack of a bad faith requirement is the most unique feature of the reasonable expectation approach. *Id.*

148. *Id.; see also In re* Topper, 107 Misc. 2d 25, ____, 433 N.Y.S.2d 359, 362 (N.Y. Sup. Ct. 1980) (cause and business judgment irrelevant when minority shareholder's reasonable expectations are frustrated).

149. *See* Peeples, *supra* note 20, at 504. Peeples contends that "[t]he absence of any bad faith or fault requirement suggests that the reasonable expectations analysis should prevail over the business judgment rule. . . . [T]he business judgment rule should not affect a court-ordered dissolution or buy-out based on a finding that a shareholder's reasonable expectations have been frustrated." *Id.*

150. *See* Hillman, *supra* note 26, at 55-60 (discussion of the "rights of interests" standards of California and North Carolina, which allow relief to minority shareholders without regard to misconduct by the majority).

151. CAL. CORP. CODE § 1800(b)(5) (West 1977); N.C. GEN. STAT. § 55-125(a)(4) (1982).

152. *See, e.g.*, Stumpf v. C.E. Stumpf & Sons, 47 Cal. App. 3d 230, 234, 120 Cal. Rptr. 671, 674 (1975) (dissolution may be ordered "when required to assure fairness to minority shareholders").

153. *See* Hillman, *supra* note 26, at 56-57; Note, *supra* note 30, at 1008.

shareholders affect a minority shareholder without looking at the acts themselves. If the effects of an act threaten the rights or interests of a minority shareholder, both approaches may provide a basis for relief regardless of the characterization of the act itself.[154]

Not surprisingly, in North Carolina courts have adopted a reasonable expectations approach to define the rights and interests of the shareholder.[155] For example, in *Meiselman v Meiselman*[156] the court held that a complaining shareholder's "rights or interests" in a closely held corporation include her reasonable expectations in the corporation.[157] The result obtained using this analysis is the same as that obtained by utilizing the reasonable expectations approach to oppression: if a controlling shareholder frustrates the expectations of a minority shareholder, a right to relief exists.[158]

At a number of different levels, the framework outlined above justifies a court's intervention into the affairs of a closely held corporation to protect the minority shareholder. Whether the intervention is based on equitable grounds or on an existing statute, a court may characterize the actions of the controlling shareholders or the effect of those actions upon the minority shareholders in such a manner as to justify its action.

IV. THE NONINTERVENTION FRAMEWORK

The nonintervention framework is based upon those cases in which, despite allegations of unfair or oppressive conduct, courts have refused to intervene in corporate actions and have allowed controlling shareholders a certain degree of freedom. A powerful and traditional theme in corporate law is that directors and controlling shareholders are allowed to exercise great latitude in their decisionmaking process. Courts have often been loath to interfere with the internal affairs of a corporation.[159] This

154. *Compare In re* Topper, 167 Misc. 2d 25, ____, 433 N.Y.S.2d 359, 362 (N.Y. Sup. Ct. 1980) (dissolution for oppression justified when controlling shareholders damage minority shareholder's reasonable expectations and freeze-out his interest) *with* Meiselman v. Meiselman, 309 N.C. 279, ____, 307 S.E.2d 551, 562 (1983) (focus of inquiry is on whether "rights and interests" of minority shareholder need protection under statute authorizing dissolution, not on actions of majority). *See also* Note, *supra* note 30, at 1011 & n.105.

155. *See* Meiselman v. Meiselman, 309 N.C. 279, ____, 307 S.E.2d 551, 563 (1983); Lowder v. All Star Mills, Inc., 75 N.C. App. 233, ____, 330 S.E.2d 649, 655 (1985).

156. 309 N.C. 279, 307 S.E.2d 551 (1983).

157. Meiselman v. Meiselman, 309 N.C.279, ____, 307 S.E.2d 551, 563 (1983).

158. *See supra* note 154.

159. *See* 1 F. O'NEAL & R. THOMPSON, *supra* note 21, § 3:03. Courts have traditionally allowed directors and controlling shareholders a high degree of discretion in the declaration of dividends even though the withholding of dividends is the most common freeze-out technique. *Id.* § 3:05; *see supra* note 55 and accompanying text; *see also* Coduti v. Hellwig, 127 Ill. App. 3d 279, ____, 469 N.E.2d 220, 226 (1984). The court in *Coduti* noted that courts are reluctant to interfere with corporate

reluctance to meddle in the decisions of corporations has arisen primarily from two sources: the business judgment rule and the principle of majority rule in corporate management.[160]

A. THE BUSINESS JUDGMENT RULE

The business judgment rule occupies a sacred position in corporate law.[161] A common-law principle, the business judgment rule has been a part of corporate law for at least 150 years.[162] The rule is uniformly referenced in every distillation of general corporate law.[163] It remains today a rule of extraordinary impact and controversy.[164]

The business judgment rule arose out of a judicial concern "that persons of reason, intellect, and integrity would not serve as directors if the law exacted from them a degree of prescience not possessed by people of ordinary knowledge."[165] The law had to acknowledge the fallibility of directors and the need to prevent review of their every business decision.[166] Early formulations of the

decisions concerning the withholding of dividends "unless the withholding is fraudulent, oppressive, or totally without merit." *Id.* (quoting Romanik v. Lurie Home Supply Center, Inc., 105 Ill. App. 3d 1118, 1134, 435 N.E.2d 712, 723 (1982)).

160. *See* 1 F. O'NEAL & R. THOMPSON, *supra* note 21, § 3:03; O'Neal, *supra* note 31, at 884. For a discussion of the business judgment rule and the principle of majority rule, see *infra* notes 161-195 and accompanying text.

161. Peeples, *supra* note 20, at 456; *see* Terrell, *Bricks for the Business Judgment Citadel — Recent Developments in Delaware Corporate Law,* 9 DEL. J. CORP. L. 329 (1984) (the bedrock of corporate governance is the business judgment rule).

162. Arsht, *The Business Judgment Rule Revisited,* 8 HOFSTRA L. REV. 93, 93 (1979); *see, e.g.,* Smith v. Prattville Mfg., 29 Ala. 503 (1857); Hodges v. New England Screw Co., 1 R.I. 312 (1850), *aff'd on rehearing,* 3 R.I. 9 (1853).

163. Peeples, *supra* note 20, at 456; *see, e.g.,* W. CARY & M. EISENBERG, CASES AND MATERIALS ON CORPORATIONS 537-53 (5th ed. 1980).

164. *See generally* Cohn, *Demise of the Director's Duty of Care: Judicial Avoidance of Standards and Sanctions Through the Business Judgment Rule,* 62 TEX. L. REV. 591 (1983) (discussion of the dominance of the business judgment rule in duty of care litigation against corporate directors); Pease, Aronson v. Lewis: *When Demand Is Excused and Delaware's Business Judgment Rule,* 9 DEL. J. CORP. L. 39 (1984) (review of power of independent committees to dismiss derivative action on basis of business judgment); Terrell, *supra* note 161 (review of status of business judgment rule).

The power of independent committees to dismiss derivative actions asserted against the corporation and to have that decision protected by the business judgment rule is a matter of great import and current controversy. Cohn notes that "[b]ecause a derivative action asserts a corporate right, the decision whether to pursue such action theoretically belongs to the directors." Cohn, *supra,* at 591 n.3. A shareholder bringing such an action must prove that the board of directors, upon her request, has failed to redress the wrong or that such a request is futile. *Id.*

Cohn explains that in an effort to reassert a board role, boards form ad hoc litigation committees composed of nondefendant directors (who may have been appointed to the board especially for such service) to determine the corporation's response to the derivative actions. *Id.* Not surprisingly, these committees generally decide to seek a dismissal of the derivative action. *Id.* The rising popularity of such committees has created a good deal of litigation regarding the appropriate judicial standard for the review of such decisions. *Id.; see also* Zapata Corp. v. Maldonado, 430 A.2d 779, 788 (Del. 1981) (even if independence and reasonable procedure are proved, court should apply its own business judgment); Auerbach v. Bennett, 47 N.Y.2d 619, 623-24, 393 N.E.2d 994, 996, 419 N.Y.S.2d 920, 921 (1979) (committee's business judgment to seek dismissal beyond judicial review except for questions of independence and procedure).

165. Arsht, *supra* note 162, at 97; *see also* 1 F. O'NEAL & R. THOMPSON, *supra* note 21, § 3:03, at 6 (the business judgment rule encourages able and responsible persons to accept corporate office).

166. Arsht, *supra* note 162, at 95.

business judgment rule recognized the folly of requiring directors to exercise perfect judgment.[167] Directors were to be held responsible for their decisions only upon a showing that their error was of "a kind so gross that people of common sense and ordinary attention would not have fallen into it."[168]

The general idea of the business judgment rule remains as it was over a hundred years ago: When directors have acted with reasonable care and in good faith, their decisions will be considered business judgments and they will not be liable for the consequences of such judgments.[169] While the general contours of the business judgment rule have remained static, the specific contests of the rule are unsettled. For example, one formulation of the rule interprets it as preventing a court's interference with a business judgment decision absent "gross and palpable" overreaching.[170] Another formulation provides that the judgment of the directors will not be disturbed if it can be attributed to any rational business purpose.[171]

The Delaware Supreme Court, the prime developer of the various forms of the business judgment rule, recently attempted a restatement of the rule in *Aronson v. Lewis*.[172] In *Aronson* the court wrote:

> [The business judgment rule] is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company. Absent an abuse of discretion, that judgment will be respected by the courts.[173]

The court noted that the business judgment rule does not apply if the directors were "interested" or lacked independence,[174] failed to

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167. *See, e.g.*, Godbold v. Branch Bank, 11 Ala. 191, 199 (1847); Percy v. Millaudon, 8 Mart. (n.s.) 68, 77-78 (La. 1829).

168. Arsht, *supra* note 162, at 97-99 (quoting Percy v. Millaudon, 8 Mart. (n.s.) 68, 78 (La. 1829)).

169. *Compare* Manning, *The Business Judgment Rule In Overview*, 45 OHIO ST. L.J. 615, 617 (1984) (when a board of directors has acted with reasonable care and in good faith, its decisions will be regarded as business judgments and the directors will not be liable for damages, even when a decision proves to be detrimental to the corporation) *with* Hodges v. New England Screw Co., 3 R.I. 9, 18 (1853) ("a board of directors acting in good faith and with reasonable care and diligence, who nevertheless fall into a mistake, either as to law or fact, are not liable for the consequences of such a mistake"), *aff'g on rehearing*, 1 R.I. 312 (1850).

170. *See, e.g.*, Getty Oil Co. v. Skelly Oil Co., 267 A.2d 883, 887 (Del. 1970); Meyerson v. El Paso Natural Gas Co., 246 A.2d 789, 794 (Del. 1967).

171. *See, e.g.*, Sinclair Oil Corp. v. Levien, 280 A.2d 717, 721-22 (Del. 1971).

172. 473 A.2d 805 (Del. 1984).

173. Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (citations omitted). The court in *Aronson* surveyed a long line of Delaware cases attempting to define the parameters of the business judgment rule and acknowledged the imprecision of the rule's definition. *See id.*

174. *Id.* The court noted that "interest" means that directors cannot appear on both sides of a transaction. *Id.* In addition, they cannot expect to obtain any personal financial benefits through self-

inform themselves of all available material information,[175] or failed to act with requisite care in the discharge of their duties.[176] Requisite care is predicated on the standard of gross negligence.[177]

When a decision of the directors or controlling shareholders is challenged by a shareholder, the directors and controlling shareholders invariably invoke the protection of the business judgment rule.[178] Many courts have interpreted the rule as limiting judicial review of business decisions and requiring a policy of deference to the decisions of directors and controlling shareholders.[179] By invoking the business judgment rule, directors and controlling shareholders attempt to keep the reasons for, and the fairness of their decisions and actions immune from review.

B. THE PRINCIPLE OF MAJORITY RULE

Courts have also used the concept of majority rule, although less explicitly than the business judgment rule, to justify a policy of nonintervention into corporate decisions.[180] Generally, a corporation operates under the principle of majority rule. Under this principle, the holders of a majority of the shares control the corporation and elect the majority of the board of directors.[181] As a general proposition, directors are responsive to the wishes of the

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dealing as opposed to benefits that devolve upon the corporation or all of the stockholders generally. *Id.*; *see also* 1 F. O'NEAL & R. THOMPSON, *supra* note 21, § 3:03, at 6 (business judgment rule "does not apply if the directors are on both sides of a transaction in a self-dealing situation").

175. Aronson v. Lewis, 473 A.2d at 812; *see also* Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985). In *Smith* the court noted that the business judgment rule does not protect directors who have made "'an unintelligent or unadvised judgment.' " *Id.* (quoting Mitchell v. Highland-W. Glass, 19 Del. Ch. 326, ____, 167 A. 831, 833 (1933)). The court also noted that a director's duty to inform himself "derives from the fiduciary capacity in which he serves the corporation and its stockholders." *Id.*

176. Aronson v. Lewis, 473 A.2d at 812; *see also* Smith v. Van Gorkom, 488 A.2d at 872-73 (a director's duty to exercise an informed business judgment is in the nature of a duty of care, not loyalty).

177. Aronson v. Lewis, 473 A.2d at 812 & n.6.

178. *See, e.g.*, id. at 805, 810; Coduti v. Hellwig, 127 Ill. App. 3d 279, _____, 469 N.E.2d 220, 226 (1984); *In re* Topper, 107 Misc. 2d 25, _____, 433 N.Y.S.2d 359, 361 (N.Y. Sup. Ct. 1980).

179. *See* Puma v. Marriott, 283 A.2d 693, 696 (Del. Ch. 1971) (courts precluded from substituting their uninformed opinion); Coduti v. Hellwig, 127 Ill. App. 3d 279, ____, 469 N.E.2d 220, 226 (1984) (courts reluctant to interfere); Mountain Manor Realty, Inc. v. Buccheri, 55 Md. App. 185, ____, 461 A.2d 45, 50 (1983) (courts may not second guess business decisions); Auerbach v. Bennett, 47 N.Y.2d 619, ____, 393 N.E.2d 994, 1000, 419 N.Y.S.2d 920, 926 (1979) (courts ill-equipped to evaluate business judgments); 1 F. O'NEAL & R. THOMPSON, *supra* note 21, § 3:03, at 5 ("[t]he business judgment rule embodies a broad judicial deference to a corporation's board of directors to determine business policy and to conduct corporate affairs").

180. *See* 2 F. O'NEAL & R. THOMPSON, *supra* note 21, § 10:04; O'Neal, *supra* note 31, at 884; *see also* Hand v. Dexter, 41 Ga. 454, 462 (1871) ("[t]he very foundation principle of a corporation is that a majority of its stockholders have a right to manage its affairs"); Coduti v. Hellwig, 127 Ill. App. 3d 279, ____, 469 N.E.2d 220, 229 (1984) (the majority of the corporation's stockholders controls the policy of the corporation).

181. 1 F. O'NEAL & R. THOMPSON, *supra* note 21, § 1:02.

shareholders who elect them.[182] Normally, in closely held corporations the majority of directors are in fact the controlling shareholders.[183]

The concept of majority rule operates at two levels. First, it validates the exercise of the business judgment of the directors and controlling shareholders. Because the directors have been elected by a majority of the shareholders, their business judgment should be accorded respect. This view is represented by a New York Supreme Court's decision in *Alpert v. 28 William Street Corp.*[184] In *Alpert* minority shareholders brought an action challenging the merger and dissolution of a corporation.[185] The court immediately recognized that the actions complained of were taken by directors elected by a majority of the shareholders and noted:

> Under the law, corporate directors elected by a majority of shareholders, are accorded a great deal of leeway in their dealings with the corporation. The courts generally have adopted the view that any actions taken by directors which can be considered a proper exercise of business judgment are not to be reviewed in the courtroom. The forum for such consideration is the boardroom.[186]

The notion is that a person who becomes a shareholder in a corporation assents to rule by the majority of shareholders and implicitly agrees to abide by the business decisions of the majority.[187] The concept of majority rule brings a further

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182. *Id.* The principle of majority rule has been modified somewhat by statutes that require the favorable vote of two-thirds of the shareholders for certain fundamental corporate acts. *See, e.g.*, N.D. CENT. CODE § 10-19.1-05 (1985) (retaining the requirement of a two-thirds majority vote absent provision to the contrary in the articles of incorporation).

183. 1 F. O'NEAL & R. THOMPSON, *supra* note 21, § 1:02, at 3 ("in most closely held corporations, majority shareholders elect themselves and their relatives to all or most of the positions on the board").

184. 124 Misc. 2d 512, 478 N.Y.S.2d 443 (N.Y. Sup. Ct. 1983).

185. Alpert v. 28 William St. Corp., 124 Misc. 2d 512, ____, 478 N.Y.S.2d 443, 446 (N.Y. Sup. Ct. 1983). The minority shareholders alleged that the proposed merger and dissolution was unfair and motivated by self-interest. *Id.* The merger plan was to buy out the minority shares at the same price paid for the majority shares and then dissolve the corporation for the purpose of accruing benefits to the majority shareholders. *Id.*

186. *Id.* The court noted that there was no claim of fraud or gross illegality on the part of the directors of the corporation. *Id.*

187. Coduti v. Hellwig, 127 Ill. App. 3d 279, ____, 469 NE.2d 220, 229 (1984). The court in *Coduti* described the concept of majority rule as follows:

> Every one purchasing or subscribing for stock in a corporation impliedly agrees that he will be bound by the acts and proceedings done or sanctioned by a majority of the shareholders, or by the agents of the corporation duly chosen by such majority, within the scope of the powers conferred by the charter, and courts of equity will not undertake to control the policy or business methods of a corporation, although it may

legitimacy to the controlling shareholders' exercise of business judgment and thus strengthens the judicial view that it is inappropriate to interfere with corporate decisions.

Second, the concept of majority rule allows directors and controlling shareholders additional freedom to engage in certain types of behavior.[188] This additional freedom has been termed the rights of "selfish ownership."[189] In *Alpert* the court discussed the existence of "selfish ownership" rights and determined that self interest does not necessarily undermine the validity of business decisions made by the directors.[190] This is a recognition by some courts that directors and controlling shareholders have a right to take certain actions that in other circumstances might be questioned. Self interest on the part of directors and controlling shareholders is normal and does not undermine the validity of business decisions.[191] This view strengthens the protections of the business judgment rule. While courts have often stated that proof of self interest will allow a court to inquire into a corporate decision,[192] judicial review of certain corporate decisions is inhibited by the recognition that directors and controlling shareholders exercise some self interest in the normal course of events.[193]

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be seen that a wiser policy might be adopted and the business more successful if other methods were pursued.

Id. (quoting Wheeler v. Pullman Iron & Steel Co., 143 Ill. 197, 207, 32 N.E. 420, 423 (1892)); *see also* Benton v. United States, 114 F. Supp. 37, 45 (M.D. Ga. 1953) ("when a person becomes a stockholder in a corporation, he assents to majority rule and impliedly agrees to abide thereby").

188. *See* 1 F. O'NEAL & R. THOMPSON, *supra* note 21, § 3:03. The authors note that majority shareholders elect the directors of the corporation who in turn select the officers and employees, fix compensation for themselves, determine business policies, and manage the corporation. *Id.* § 3:03, at 5. The minority shareholders and directors are subject to the "grace or acquiescence" of the majority shareholders. *Id.; see also* Ringling Bros.-Barnum & Bailey Com. Shows v. Ringling, 29 Del. Ch. 610, ____, 53 A.2d 441, 447 (1947) (shareholders may vote for personal profit).

189. Wilkes v. Springside Nursing Home, Inc., 370 Mass. 842, ____, 353 N.E.2d 657, 663 (1976). The court in *Wilkes* noted that the majority's right of "selfish ownership" in the corporation should be balanced against their fiduciary obligation to the minority. *Id.* at ____, 353 N.E.2d at 663. *See generally* Hill, *The Sale of Controlling Shares,* 70 HARV. L. REV. 986, 1013-15 (1957) (discussion of the concept of "selfish ownership").

190. Alpert v. 28 William St. Corp., 124 Misc. 2d 512, ____, 478 N.Y.S.2d 443, 448-49 (N.Y. Sup. Ct. 1983). The court in *Alpert* described the rights of "selfish ownership" as follows:

> Self-interest is not, under our economic system, a crime. It does not, in and of itself, undermine the validity of a whole host of business transactions. To state otherwise would require all our corporate directors to be self-denying, vestal virgins who would never consider the possibility of any action ever redounding to their own benefit.
>
> Such selfless dedication may be appropriate for monastic life; it is not appropriate for business life in twentieth century America.

Id.

191. *See* 1 F. O'NEAL & R. THOMPSON, *supra* note 21, § 3:03.

192. *See, e.g.,* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (business judgment rule protects only disinterested directors whose conduct meets the tests of business judgment); Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971) (directors may not appear on both sides of a transaction nor derive any self-dealing financial benefit).

193. *See, e.g.,* Jackson v. St. Regis Apartments, Inc., 565 S.W.2d 178, 183 (Mo. Ct. App. 1978) (shares of stock are private property and generally may be voted in any manner the owner sees fit);

C. JUSTIFICATIONS FOR NONINTERVENTION

The business judgment rule and the principle of majority rule offer a strong defense to directors and controlling shareholders. These two concepts have been used to justify a strong presumption that courts will not normally inquire into the decisions of a corporation.[194] As reflected in countless decisions, many courts feel incapable of exercising the judgment that they believe more properly belongs in the hands of the directors and controlling shareholders. These courts believe that the directors and controlling shareholders have a right to operate their business in the manner they feel is in the corporation's best interests, and that the directors and controlling shareholders are in the best position to decide what those best interests are.[195]

Given this framework of protection for the decisions of directors and controlling shareholders, it is not surprising that minority shareholders have often had a difficult time obtaining relief from corporate actions that they claimed were unfair or oppressive. Regardless of the grounds upon which minority shareholders have requested relief, some courts invariably view the business judgment rule and the principle of majority rule as preventing full judicial review of a corporate decision.[196] Even when courts have not explicitly focused on these rules, various reasons have been employed to uphold the actions of directors and controlling shareholders.[197]

1. *Absent Statutory Authority*

Traditionally, the first obstacle for a shareholder seeking relief

Alpert v. 28 William St. Corp., 124 Misc. 2d 512, ____, 478 N.Y.S.2d 443, 448 (N.Y. Sup. Ct. 1983) (self-interest does not, in and of itself, undermine the validity of a corporate business transaction).

194. *See* 1 F. O'NEAL & R. THOMPSON, *supra* note 21, § 3:03; *see also* Wilkes v. Springside Nursing Home, Inc., 370 Mass. 842, ____, 353 N.E.2d 657, 662 (1976). In *Wilkes* the court noted that "freeze-out" techniques in close corporations have been successful because courts consistently decline to interfere with internal corporate operations. *Id.* The court stated that these internal operations involve management decisions subject to the principle of majority rule. *Id.*

195. *See, e.g.*, Alaska Plastics, Inc. v. Coppock, 621 P.2d 270, 278 (Alaska 1980) (courts are reluctant to substitute their judgment for that of the board of directors absent unequal distribution of benefits among shareholders); Mountain Manor Realty, Inc. v. Buccheri, 55 Md. App. 185, ____, 461 A.2d 45, 50 (1983) (general rule is that a court may not interfere with or second-guess business decisions made by controlling shareholders).

196. *See* cases cited *supra* note 195.

197. 1 F. O'NEAL & R. THOMPSON, *supra* note 21, § 3:03. The authors contend that many courts apparently recognize a legitimate sphere of self-interested actions by controlling shareholders even if the minority suffers. *Id.*; *see also* Fix v. Fix Material Co., 538 S.W.2d 351, 361 (Mo. Ct. App. 1976) (even though substantial evidence of oppressive and illegal conduct on the part of controlling shareholder existed, such evidence was insufficient to warrant dissolution); Baker v. Commercial Body Builders, Inc., 264 Or. 614, ____, 507 P.2d 387, 394 (1973) (even a continuing course of "oppressive" conduct may not be sufficient for dissolution unless such conduct results in a

was the lack of a statute providing for relief.[198] As noted earlier, the general rule at common law was that, absent statutory authority, courts had no jurisdiction to grant dissolution at the request of a minority shareholder.[199] With few statutes providing for dissolution or other relief at the request of a shareholder, intervention by courts was rare.[200] Courts allowed directors and controlling shareholders to exercise their judgment by default. In the few cases that courts recognized an equitable basis for intervention into a corporation's affairs, relief was limited. Courts often required a showing that the directors or controlling shareholders had engaged in fraudulent or illegal acts, or that the ruin of the corporation was imminent.[201]

2. *Within the Oppression Analysis*

When oppression became a more widely recognized basis for relief,[202] many courts were just as unwilling to intervene as they had been under earlier rationales. For example, in *Jackson v. St. Regis Apartments, Inc.*,[203] the minority shareholders brought suit against the controlling shareholders alleging oppression of their interests and rights.[204] The shareholders were tenants of an apartment building who had formed a corporation to purchase the building and operate it as a cooperative.[205] A nonuniform fee structure was imposed for the payment of services.[206] The minority shareholders argued that the imposition of an unequal fee structure for services that each shareholder shared equally was illegal and oppressive.[207] The trial court agreed and held for the minority

disproportionate loss to minority shareholders, or unless controlling shareholders cannot be trusted to manage fairly in stockholders' interests).

198. *See* Hillman, *supra* note 26, at 38 n. 120; Note, *supra* note 39, at 513-19.

199. *See supra* note 77 and accompanying text.

200. West Virginia did have a dissolution statute as early as 1868. *See* W. VA. CODE § 53-57 (1868) (current version at W. VA. CODE § 31-1-134 (1982)). However, it was not until 1933 in Illinois that oppression became a standard for relief. *See supra* note 85. Without statutory authorization, courts were reluctant to offer relief even in the face of abusive conduct by those in control of the corporation. *See* Hillman, *supra* note 26, at 38; Note, *supra* note 30, at 1005-06 & n.57; *see, e.g.*, Hardon v. Newton, 11 F. Cas. 500, 501 (D. Conn. 1878) (No. 6054).

201. *See, e.g.*, Dixie Lumber Co. v. Hellams, 202 Ala. 488, ____, 80 So. 872, 874 (1919); Phinizy v. Anniston City Land Co., 195 Ala. 656, ____, 71 So. 469, 471 (1916); Manufacturers' Land & Improvement Co. v. Cleary, 121 Ky. 403, ____, 89 S.W. 248, 249 (1905); James F. Powers Foundry Co. v. Miller, 166 Md. 590, ____, 171 A. 842, 845 (1934).

202. The Illinois legislation led to the adoption of the oppression standard by numerous other states. For a partial listing of states that have incorporated the oppression standard into dissolution statutes, see *supra* note 86.

203. 565 S.W.2d 178 (Mo. Ct. App. 1978).

204. Jackson v. St. Regis Apartments, Inc., 565 S.W.2d 178, 180 (Mo. Ct. App. 1978).

205. *Id.*

206. *Id.* at 180-81. The board of directors had imposed a nonuniform fee structure for the payment of services provided to the shareholder-occupants despite the fact that each shareholder-occupant received equal services. *Id.*

207. *Id.* at 181. The minority shareholders testified that they were informed of the amount of the service fee for their apartments but were not told of the variance in fees between the separate shareholder-occupants. *Id.*

shareholders.[208] The Missouri Court of Appeals reversed, noting that shares of stock are private property and generally may be voted in any manner the owner sees fit.[209] The court held that absent fraud, it was not appropriate for a court to substitute its judgment concerning the proper management of the corporation.[210]

The court's decision in *Jackson* invoked the pillars of the nonintervention framework. With respect to the business judgment rule, the court noted that errors of judgment should not be reviewed.[211] Regarding the principle of majority rule, the court explained that shareholders may vote their shares as they see fit.[212] The court's recognition of the business judgment rule and the right of controlling shareholders to control the corporation led to its decision to reverse the trial court's finding of oppression without engaging in an extensive discussion of what acts might have constituted oppressive behavior. The nonintervention framework limited the court's inquiry.

Even when courts took a closer look at what type of behavior constituted oppression, if they were unwilling to intervene they quickly invoked the business judgment rule and the principle of majority rule as justifications for their nonintervention.[213] A striking example of this approach is illustrated by the decision in *Coduti v. Hellwig*.[214] In *Coduti* a minority shareholder brought an action alleging that the controlling shareholders had engaged in a variety of oppressive acts including, among other things, a refusal to authorize dividends and wasting and misapplying corporate assets.[215] The court acknowledged that oppression might result

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208. *Id.* at 180-81. The trial court found that no evidence explained or justified the variance in fees for services that were the same for each apartment unit. *Id.* at 181. The trial court held that the imposition of the service fee structure constituted oppression because it was so arbitrary and inequitable that it was a breach of the majority's fiduciary duty. *Id.*

209. *Id.* at 183. The appellate court in *Jackson* determined that the complaining shareholders had ratified the staggered service fee because the fee was embodied in the corporation's bylaws. *Id.*

210. *Id.* The court in *Jackson* used the following language to describe the discretion permitted controlling groups in a corporation:

> "[C]ourts of equity will not, as a general rule, exercise jurisdiction to control or interfere in the management of the corporate or internal affairs of the corporation. The court has no power to interpose its authority for the purpose of adjusting controversies relative to the proper mode of conducting the corporate business. Errors of judgment on the part of the officers are not grounds for the interference of equity. For the court to intervene there must be actual or threatened acts which are ultra vires, fraudulent, and injurious, and are an abusive [sic] power, and are acts of oppression on the part of the Corporation of [sic] its officers."

Id. (quoting Golden v. St. Joseph Milk Producers' Ass'n, 420 S.W.2d 31, 33 (Mo. Ct. App. 1967)).

211. *Id.* at 183.

212. *Id.*

213. *See, e.g.*, Coduti v. Hellwig, 127 Ill. App. 3d 279, 469 N.E.2d 220 (1984).

214. 127 Ill. App. 3d 279, 469 N.E.2d 220 (1984).

215. Coduti v. Hellwig, 127 Ill. App. 3d 279, ____, 469 N.E.2d 220, 225 (1984). Coduti sought dissolution of the corporation and an accounting of the controlling shareholders for improper benefits

from behavior that was "arbitrary, overbearing and heavy-handed."[216] However, in refusing to grant the minority shareholder any relief, the court relied significantly on the principles of business judgment and majority rule. The court reasoned that the matters which the minority shareholders complained of were matters of business judgment, within the discretion of the board of directors, and with which the court would not concern itself.[217] Further, the court noted that the controlling shareholders were permitted to control the business of the corporation.[218] The court reasoned that the minority shareholders had implicitly agreed that they would be bound by the acts of the controlling shareholders and a dissatisfaction with those acts was an insufficient basis upon which to justify intervention.[219]

Courts utilizing the nonintervention framework have agreed that oppressive conduct is something less than fraudulent or illegal conduct.[220] Beyond that, however, there is little common ground concerning the definition of "oppression."[221] The flexibility of the definition allowed courts an equal amount of flexibility in characterizing actions of controlling shareholders as not oppressive. In *Baker v. Commercial Body Builders, Inc.*[222] the controlling shareholders discharged the minority shareholders from

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received from the corporation. *Id.* at ____, 469 N.E.2d at 223. Coduti alleged that Hellwig, the majority shareholder, refused to authorize bonuses or dividends despite large corporate case reserves, refused to allow Coduti's attorney to attend directors' meetings, held directors' meetings without notice to Coduti, caused the arrest of Coduti, opened his mail, and degraded him in the presence of others. *Id.* at ____, 469 N.E.2d at 225.

216. *Id.* The court in *Coduti* examined a variety of conduct that had or had not been regarded as oppressive. *Id.* However, the court noted that "a review of the case law discloses no single act, which, by itself, will be deemed oppressive without consideration of the surrounding circumstances." *Id.* Thus, the court stated that oppression must be determined in light of the facts of each case. *Id.*

217. *Id.* at ____, 469 N.E.2d at 226, 229. The court first addressed whether Hellwig's refusal to authorize bonuses or dividends while the corporation amassed large reserves constituted oppression. *Id.* at ____, 469 N.E.2d at 226. The court stated that when funds are available decisions concerning dividend declarations rest within the discretion of the board, and courts are reluctant to interfere " 'unless the withholding is fraudulent, oppressive or totally without merit.' " *Id.* (quoting Romanik v. Lurie Home Supply Center, Inc., 105 Ill. App. 3d 1118, 1134, 435 N.E.2d 712, 723 (1982)). The court also determined that Hellwig's decision to pay membership dues in advance was a matter of business judgment and the responsibility of the board of directors, not the concern of the court. *Id.* at ____, 469 N.E.2d at 229.

218. *Id.* at ____, 469 N.E.2d at 229.

219. *Id.* at ____, 469 N.E.2d at 229-30 (quoting Wheeler v. Pullman Iron & Steel Co., 143 Ill. 197, 207, 32 N.E.420, 423 (1892). For a discussion of the principle of majority rule, see *supra* notes 180-93 and accompanying text.

220. *See, e.g.,* Gidwitz v. Lanzit Corrugated Box Co., 20 Ill. 2d 208, 214-15, 170 N.E.2d 131, 135 (1960) (oppression is not synonymous with illegal and fraudulent); Fix v. Fix Material Co., 538 S.W. 2d 351, 357-58 (Mo. Ct. App. 1976) (oppression is "an independent ground for relief not requiring a showing of fraud, illegality, mismanagement, wasting of assets, nor deadlock, though these factors are frequently present").

221. *See* Coduti v. Hellwig, 127 Ill. App. 3d 279, ____, 469 N.E.2d 220, 225 (1984) (no single act is deemed oppressive without consideration of the surrounding circumstances); *see also* Hillman, *supra* note 26, at 45, 49; Note, *supra* note 39, at 520.

222. 264 Or. 614, 507 P.2d 387 (1973).

employment, removed the minority shareholders as directors, failed to notify them of meetings, falsified corporate records to indicate that the minority shareholders had been notified of or were present at such meetings, denied them access to corporate records, and advanced corporate funds to another company in which one of the controlling shareholders held an interest.[223] Despite the existence of a broad definition of oppression,[224] the court held that relief was unwarranted.[225] Apparently, the fact that the acts of the controlling shareholders had occurred over a one year period and had not continued was reason enough to deny relief to the minority shareholders.[226]

Other applications and interpretations of oppression allowed courts to characterize the acts of the controlling shareholders in a manner that denied minority shareholders relief. Some courts required a continuing series of oppressive acts, relief being justified only upon an accumulation of such acts.[227] Other courts, while recognizing oppression as an independent ground for relief that did not require a showing of fraud or illegality, acknowledged that fraudulent or illegal conduct was often present as well.[228] Courts frequently characterized the acts of controlling shareholders as not oppressive because of this difficulty in addressing oppression as an independent source of relief.

3. *Within the Fiduciary Duty/Reasonable Expectations Analysis*

When courts refined the definition of oppression by incorporating the concepts of fiduciary duty and reasonable expectations, the nonintervention framework provided a response.

223. Baker v. Commercial Body Builders, Inc., 264 Or. 614, ___, 507 P.2d 387, 396 (1973).

224. *Id.* at ___, 507 P.2d at 393-94. The court defined "oppressive conduct" as follows:

> " '[B]urdensome, harsh and wrongful conduct; a lack of probity and fair dealing in the affairs of a company to the prejudice of some of its members; or a visual departure from the standards of fair dealing, and a violation of fair play on which every shareholder who entrusts his money to a company is entitled to rely.' "

Id. (quoting Scottish Co-op. Wholesale Soc'y Ltd. v. Meyer, [1958] 3 All E.R. 66, 71, 86 (H.L.) and Elder v. Elder & Watson, Ltd., [1952] Sess. Cas. 49, 55).

225. *Id.* at ___, 507 P.2d at 398. The court determined that granting dissolution could destroy the assets of the corporation, result in a return to the shareholders of much less than the book value of their stock, and be very costly. *Id.* Consequently, the court held that although some of the conduct of the majority shareholders was "oppressive," that alone did not justify relief. *Id.*

226. *Id. Baker* represents a traditional approach under which severe misconduct is required for a finding of oppression, despite the court's broad definition of oppression. Hillman, *supra* note 26, at 45.

227. *See, e.g.,* Baker v. Commercial Body Builders, Inc., 264 Or. 614, ___, 507 P.2d 387, 394 (1973) (even a continuing course of "oppressive" conduct may not be sufficient for dissolution absent incorrigible conduct or a disproportionate loss to the minority).

228. *See, e.g.,* Fix v. Fix Material Co., 538 S.W.2d 351, 358 (Mo. Ct. App. 1976) (although oppression suggests "burdensome, harsh and wrongful conduct," these are merely perimeters of the broad term, not narrow definitions that rob the term of its flexibility).

While some courts recognized the existence of an enhanced fiduciary duty,[229] others were reluctant to apply the concept without the limiting principles of business judgment and majority rule.[230] In *Wilkes v. Springside Nursing Home, Inc.*,[231] the court was concerned that untempered application of the strict good faith standard would "result in the imposition of limitations on legitimate action by the controlling group."[232] The court felt that such limitations would unduly hamper the controlling group's effectiveness in managing the corporation in the best interests of all concerned.[233] The court stated that the majority has rights to "selfish ownership" which must be balanced against their fiduciary obligation to the minority.[234] In addition, the court acknowledged that the controlling group must have broad discretion in establishing the business policy of the corporation.[235]

Some courts have recognized this need for discretion and refused to provide relief to complaining shareholders despite the court's acknowledgment of a fiduciary duty.[236] In the companion cases of *Zidell v. Zidell, Inc.*,[237] a minority shareholder sued to compel payment of dividends[238] and to require the controlling shareholder to transfer stock to the corporation.[239] The court recognized that the controlling group owed a fiduciary duty to the minority shareholders.[240] Yet despite undisputed hostility between the controlling and minority shareholders, and concededly

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229. *See, e.g.*, Donahue v. Rodd Electrotype Co., 367 Mass. 578, ____, 328 N.E.2d 505, 515 (1975). For a discussion of the enhanced fiduciary duty recognized in *Donahue*, see *supra* note 112.

230. *See, e.g.*, Coduti v. Hellwig, 127 Ill. App. 3d 279, ____, 469 N.E.2d 220, 229-30 (1984); Wilkes v. Springside Nursing Home, Inc., 370 Mass. 842, ____, 353 N.E.2d 657, 663 (1976).

231. 370 Mass. 842, 353 N.E.2d 657 (1976).

232. Wilkes v. Springside Nursing Home, Inc., 370 Mass. 842, ____, 353 N.E.2d 657, 663 (1976).

233. *Id.*

234. *Id.*

235. *Id.* The court noted that the actions of the controlling shareholders in a close corporation must be analyzed individually in every case alleging a breach of the strict good faith duty. *Id.* In each case, the controlling shareholders must demonstrate a legitimate business purpose for their actions. *Id.* However, the court noted that the controlling shareholders must have discretion in establishing the business policy of the corporation and that this may be used to show a legitimate business purpose for their actions. *Id.* The court stated the scope of the controlling group's discretion as follows:

> [The controlling group] must have a large measure of discretion, for example, in declaring or withholding dividends, deciding whether to merge or consolidate, establishing the salaries of corporate officers, dismissing directors with or without cause, and hiring and firing corporate employees.

Id.

236. *See, e.g.*, Zidell v. Zidell, Inc., 277 Or. 413, 560 P.2d 1086 (1977); Zidell v. Zidell, Inc., 277 Or. 423, 560 P.2d 1091 (1977) (companion cases).

237. 277 Or. 413, 560 P.2d 1086 (1977); 277 Or. 423, 560 P.2d 1091 (1977).

238. Zidell v. Zidell, Inc., 277 Or. 413, ____, 560 P.2d 1086, 1087 (1977) (dividend case).

239. Zidell v. Zidell, Inc., 277 Or. 423, ____, 560 P.2d 1091, 1091 (1977) (transfer case).

240. Zidell v. Zidell, Inc., 277 Or. at ____, 560 P.2d at 1089; Zidell v. Zidell, Inc., 277 Or. at ____, 560 P.2d at 1094.

generous salaries and bonuses for shareholder employees,[241] the court held that the minority shareholder had no right to relief.[242] The court not only recognized the corporation's need to tailor its policies as it saw fit, but also noted that the minority shareholder was no different than any minority shareholder who had no larger voice in corporate affairs than her percentage of stock ownership.[243] A corporation's need to exercise its business judgment and the right of controlling shareholders to control the corporation justified the court's refusal to intervene.[244]

The nonintervention framework justified limitation of the reasonable expectations approach as well, whether that approach was through the oppression standard or the rights and interests statutes. While some courts have applied the reasonable expectations approach,[245] others have recognized the need to allow corporate decisionmakers some discretion in their decisionmaking.[246] In *Exadaktilos v. Cinnaminson Realty Co.*,[247] a minority shareholder brought suit against the controlling shareholders alleging that the controlling shareholders had engaged in oppressive conduct by violating his reasonable expectations.[248] Apparently, the minority shareholder had an expectation that he would be employed by the corporation and that he would participate in the management of the corporation.[249] After having been employed for a period of time, the minority shareholder was discharged.[250]

While acknowledging that the business judgment rule had often been used to justify oppressive conduct, the court allowed the controlling shareholders to discharge the minority shareholder.[251]

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241. Zidell v. Zidell, Inc., 277 Or. at ____, 560 P.2d at 1089.

242. *Id.* at ____, 560 P.2d at 1090; Zidell v. Zidell, Inc., 277 Or. at ____, 560 P.2d at 1095.

243. Zidell v. Zidell, Inc., 277 Or. at ____, 560 P.2d at 1094-95.

244. Zidell v. Zidell, Inc., 277 Or. at ____, 560 P.2d at 1089-90; Zidell v. Zidell, Inc., 277 Or. at ____, 560 P.2d at 1094-95.

245. For a discussion of the reasonable expectations approach, see *supra* notes 122-49 and accompanying text.

246. *See, e.g.*, Capitol Toyota, Inc. v. Gervin, 381 So. 2d 1038 (Miss. 1980); Exadaktilos v. Cinnaminson Realty Co., 167 N.J. Super. 141, 400 A.2d 554 (N.J. Super. Ct. Law Div. 1979), *aff'd per curiam*, 173 N.J. Super. 559, 414 A.2d 994 (N.J. Super. Ct. App. Div. 1980); *see also* Note, *supra* note 39, at 533-34.

247. 167 N.J. Super. 141, 400 A.2d 554 (N.J. Super. Ct. Law Div. 1979), *aff'd per curiam*, 173 N.J. Super. 559, 414 A.2d 994 (N.J. Super. Ct. App. Div. 1980).

248. Exadaktilos v. Cinnaminson Realty Co., 167 N.J. Super. 141, ____, 400 A.2d 554, 556-61 (N.J. Super. Ct. Law Div. 1979), *aff'd per curiam*, 173 N.J. Super. 559, 414 A.2d 994 (N.J. Super. Ct. App. Div. 1980). In *Exadaktilos* a stock certificate representing 20% of the interest in a corporation was given to the plaintiff. *Id.* at ____, 400 A.2d at 556. The small corporation operated a restaurant. *Id.* at ____, 400 A.2d at 561. The plaintiff's reasonable expectations included a salary and eventual participation in management. *Id.* The defendants introduced evidence indicating that the plaintiff's expectations were thwarted by his own failure to learn the business, which was a condition precedent to participation in the corporation. *Id.* at ____, 400 A.2d at 561-62.

249. *Id.*

250. *Id.* at ____, 400 A.2d at 561.

251. *Id.* at ____, 400 A.2d at 561-62. The court noted that the business judgment rule does not allow judicial tampering with board of director decisions concerning corporate affairs so long as the

The court explained that the minority shareholder had been discharged because of his unsatisfactory performance and that his expectations of employment and management participation were thwarted by his own conduct.[252] The minority shareholder's conduct allowed the court to uphold the controlling shareholders' exercise of judgment despite its frustration of the minority shareholder's reasonable expectations.[253] Within the nonintervention framework, the reasonable expectations of a shareholder are not allowed to dictate whether relief is available. A court may look beyond the effect that the controlling shareholders' acts have on the minority shareholder to the reasons for those acts. Those reasons may justify frustration of a shareholder's reasonable expectations.

The above cases set out a framework that protects the decisions of directors and controlling shareholders. In this framework, minority shareholders have a difficult time obtaining relief. Courts defer to the expertise of the directors and controlling shareholders and allow them to make business judgments. Courts allow controlling shareholders to control the corporation. The framework provides the arguments that directors and controlling shareholders may use to immunize their decisions from extensive judicial review. Utilizing this framework, a court can justify its refusal to intervene.

V. THE NORTH DAKOTA INVOLUNTARY DISSOLUTION STATUTE

The frameworks discussed above provide a structure within which to analyze North Dakota's new involuntary dissolution statute, embodied in section 10-19.1-115 of the North Dakota Century Code.[254] The statute's provisions look very different depending on the framework applied. The provisions of subsection 10-19.1-115(1)(b)(2) allow a shareholder to proceed against the corporation when the directors or those in control have acted fraudulently, illegally, or in a manner unfairly prejudicial toward

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decision is within the scope of their authority and there is no showing of bad faith. *Id.* at ____, 400 A.2d at 559.

252. *Id.* at ____, 400 A.2d at 561-62. In *Exadaktilos* the evidence showed that the plaintiff had caused the loss of key personnel by failing to get along with them, that he had quit several times without reason or notice, and that he was incompatible with the other shareholders. *Id.* at ____, 400 A.2d at 561. The court determined that the plaintiff was discharged because of his failure to learn the business and his unsatisfactory performance. *Id.*

253. *See id.* at ____, 400 A.2d at 561-62; *see also* Capitol Toyota, Inc. v. Gervin, 381 So. 2d 1038, 1039 (Miss. 1980) (although the minority shareholder's reasonable expectations were frustrated by his discharge, his inadequate management of the corporation justified denying dissolution).

254. *See supra* notes 3, 12-15 and accompanying text. For the full text and a discussion of the North Dakota involuntary dissolution statute, see *supra* notes 3, 12-15 and accompanying text.

the shareholder.[255] To guide the court's application of the provision, the legislature has indicated in subsection 10-19.1-115(3) that a court should consider both the duty that shareholders in a closely held corporation owe one another to act in an honest, fair, and reasonable manner, and the shareholders' reasonable expectations.[256] The statute sets out language from the intervention framework. It requires a court to consider the fiduciary duty existing between controlling shareholders and minority shareholders and the reasonable expectations of the shareholders.[257] The nonintervention framework provides a response to each of these standards.[258] The analysis of the statute lies in an examination of these standards and their responses.

The provisions of section 10-19.1-115 are identical to provisions in Minnesota's involuntary dissolution statute.[259] Minnesota's provisions were adopted in 1983 when the Minnesota Legislature amended its involuntary dissolution statute.[260] The legislature intended that the amendments provide a broader basis for intervention.[261] Reference to the Minnesota statute and its background may help explain and predict the impact of the North Dakota provisions.

Initially, the North Dakota involuntary dissolution statute provides that "unfairly prejudicial" conduct will justify equitable relief or dissolution.[262] Only the statutes of North Dakota, Minnesota, and South Carolina provide this exact basis for relief.[263] In a majority of states, oppression is the standard for equitable relief or dissolution.[264] When the term "unfairly prejudicial" was added to the Minnesota statute, it replaced the term "presistently unfair."[265] To prove "presistently unfair"

255. N.D. CENT. CODE § 10-19.1-115(1)(b)(2) (1985).

256. *Id.* § 10-19.1-115(3).

257. *Id.*

258. The reasonable expectations of a shareholder may justify relief without reference to the acts of the controlling shareholders. *See In re* Topper, 107 Misc. 2d 25, ____, 433 N.Y.S.2d 359, 362 (N.Y. Sup. Ct. 1980) (whether discharge of minority shareholder was for cause or in good business judgment is irrelevant when his reasonable expectations are severely damaged). The nonintervention framework allows the controlling shareholders to exercise their judgment. *See* Exadaktilos v. Cinnaminson Realty Co., 167 N.J. Super. 141, ____, 400 A.2d 554, 561-62 (N.J. Super. Ct. Law Div. 1979), *aff'd per curiam*, 173 N.J. Super. 559, 414 A.2d 994 (N.J. Super. Ct. App. Div. 1980) (controlling shareholders' conduct in discharging minority shareholder upheld despite frustration of minority shareholder's reasonable expectations).

259. *Compare* N.D. CENT. CODE § 10-19.1-115(1) (1985) *with* MINN. STAT. ANN. § 302A.751(1) (West 1985).

260. *See* Act of June 14, 1983, ch. 368, § 9, 1983 Minn. Sess. Law Serv. 2776, 2780 (West) (current version at MINN. STAT. ANN. § 302A.751(1) (West 1985)).

261. MINN. STAT. ANN. § 302A.751 reporter's notes — 1982 to 1984 (West 1985).

262. N.D. CENT. CODE § 10-19.1-115(1)(b)(2) (1985).

263. *See* MINN. STAT. ANN. § 302A.751(1)(b)(2) (West 1985); N.D. CENT. CODE § 10-19.1-115(1)(b)(2) (1985); S.C. CODE ANN. § 33-21-150(a)(4)(B) (Law. Co-op. Supp. 1985).

264. For a listing of dissolution statutes, see *supra* note 86.

265. *See* Act of June 14, 1983, ch. 368, § 9, 1983 Minn. Sess. Law Serv. 2776, 2780 (West) (current version at MINN. STAT. ANN. § 302A.751(1) (West 1985)).

conduct under the former Minnesota statute, a shareholder was required to show repeated instances of adverse conduct by the directors or those in control of the corporation.[266] This definition was consistent with some courts' view that oppression could be shown only through a series of acts.[267] The term "unfairly prejudicial," by contrast, apparently requires only one instance of adverse conduct.[268]

Because oppression is the almost universal standard, there is little available precedent to guide a court's application of the unfairly prejudicial standard. The draftsperson of Minnesota's 1983 amendments[269] has noted that the term "unfairly prejudicial" appears in several other statutes.[270] Yet the decisions interpreting those statutes provide very little guidance.[271] It has been claimed that the key to defining what conduct is unfairly prejudicial is the impact that the conduct has on a minority shareholder.[272] Of course, the response is that the conduct and rationale of the acts of the controlling shareholders must also be examined.[273] While unfairly prejudicial conduct undoubtedly requires a lesser degree of oppressive and unfair treatment than persistently unfair conduct, it is unclear how the former term compares to broader definitions of oppression.[274]

The answer to that question may be found in the considerations the court's are to use in determining whether to order relief. The first of these considerations, contained in

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266. *See* MINN. STAT. ANN. § 302A.751 reporter's notes — 1982 to 1984 (West 1985).

267. *See, e.g.*, Baker v. Commercial Body Builders, Inc., 264 Or. 614, ____, 507 P.2d 387, 394 & n.14 (1973).

268. *See* MINN. STAT. ANN. § 302A.751 reporter's notes — 1982 to 1984 (West 1985).

269. J.E. Olson, a professor of law at Hamline University School of Law, was the draftsperson of the 1983 amendments to the Minnesota Business Corporation Act. *See* Olson, *supra* note 5, at 627n.*.

270. Olson, *supra* note 5, at 639; *see* N.J. REV. STAT. § 14A:12-7(1)(c) (Supp. 1982); S.C. CODE ANN. § 33-21-150(a)(4)(B) (Law. Co-op. Supp. 1985). The New Jersey statute does not, in fact, employ the term "unfairly prejudicial," but relies instead on the term "unfairly." *See* N.J. REV. STAT. § 14A:12-7(1)(c) (Supp. 1985).

271. Minnesota courts have yet to address unfairly prejudicial conduct as an independent source of relief. *See infra* notes 294-300 and accompanying text. South Carolina courts have decided cases under its unfairly prejudicial statute. *See, e.g.*, Segall v. Shore, 269 S.C. 31, ____, 236 S.E.2d 316, 318 (1977) (controlling shareholders' acts were oppressive and unfairly prejudicial). However, the South Carolina courts have yet to develop a working definition of the statutory language. Note, *supra* note 35, at 1146.

272. Olson, *supra* note 5, at 640. Olson contends that "[t]he court should look to the nature and magnitude of the prejudicial effects of the conduct in question. The standard is not one of frequency nor one of course of conduct, but rather prejudicial impact." *Id.* This claim is consistent with the intervention framework and provides one definition of oppression that has no reference to the actions of the controlling shareholders. *See supra* notes 150-58 and accompanying text.

273. The nonintervention framework allows controlling shareholders to exercise their business judgment despite problems it might cause the minority shareholders. *See supra* notes 246-53 and accompanying text.

274. If oppression is defined with reference to the controlling shareholders' fiduciary duty and the reasonable expectations of the shareholders, it would appear to provide as broadly based relief as relief under an unfairly prejudicial standard.

subsection 10-19.1-115(3) of the North Dakota Century Code, is the duty shareholders owe to one another to act in an honest, fair, and reasonable manner.[275] The provision establishes a fiduciary duty between the shareholders.[276] The existence of that duty was judicially established in *Donahue v. Rodd Electrotype Co.* in which the court held that shareholders owe one another a duty of strict good faith.[277]

The fiduciary duty provision of subsection 10-19.1-115(3) of the North Dakota Century Code is difficult to interpret for two reasons. First, it is not a codification of any common existing standard. [278] In Minnesota the original version of the 1983 amendment incorporated the holding from *Donahue.*[279] The amendment was changed so that the language would "specify in a realistic manner" the operative terms that describe the fiduciary duty existing between the shareholders.[280] However, it is unlikely that the language adopted — honest, fair, and reasonable — is any more realistic or specific than any other existing standard. Adoption of the *Donahue* standard would have provided at least the guidance from past applications.[281]

Second, and most importantly, describing the duty does not guide the court in applying the previously discussed frameworks. Obviously, two perspectives are possible. The first applies the analysis of the intervention framework. Under this framework, the acts of the controlling shareholders are considered oppressive if they violate the controlling shareholders' duty to act in the strictest good faith.[282] According to the intervention framework, no allowance is made for the possiblity that the acts of the controlling shareholders are within their rights as controlling shareholders or are within their business judgment.[283] The second perspective

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275. N.D. CENT. CODE § 10-19.1-115(3) (1985).

276. *See* Olson, *supra* note 5, at 647. In construing subdivision 3a of § 751 of the Minnesota Statutes, Olson contends that the subdivision clearly establishes the *existence* of a fiduciary duty among all shareholders of a closely held corporation. *Id.* (emphasis in original); *see* MINN. STAT. ANN. § 302A.751 (3)(a) (West 1985). Subdivision 3a of § 751 is almost identical to § 10-19.1-115 (3) of the North Dakota Century Code. *Compare* MINN. STAT. ANN. § 302A.751 (3)(a) (West 1985) *with* N.D. CENT. CODE § 10-19.1-115 (3) (1985).

277. Donahue v. Rodd Electrotype Co., 367 Mass. 578, ____, 328 N.E.2d 505, 515 (1975).

278. *See, e.g., id.* (fiduciary duty standard is "utmost good faith and loyalty").

279. *See* Olson, *supra* note 5, at 650 & n.145.

280. *Id.* at 651-52. Olson contends that the scope of the fiduciary duty under the Minnesota provision is, and must be, "left to judicial determination on a case-by-case basis with reference to the extensive precedent existing under partnership law and developing under corporate law and to the facts of the particular case." *Id.* at 652.

281. *See* Wilkes v. Springside Nursing Home, Inc., 370 Mass. 842, 353 N.E.2d 657 (1976); Donahue v. Rodd Electrotype Co., 367 Mass. 578, 328 N.E.2d 505 (1975).

282. *See supra* notes 101-21 and accompanying text.

283. *See* Olson, *supra* note 5, at 652. Olson notes that "[the fiduciary duty standard] is not subject . . . to such traditional corporate norms as the majority rule principle or the business judgment rule . . . ." *Id.*

applies the analysis of the nonintervention framework. Under this framework, the controlling shareholders are allowed to exercise their business judgment and control the corporation because they have a larger voice in corporate affairs.[284] A court looking for guidance is faced with a choice between the two perspectives because neither framework can be entirely reconciled with the other.

The second consideration a court must apply in determining whether to order equitable relief or dissolution under section 10-19.1-115 is "the reasonable expectations of the shareholders as they exist at the inception and develop during the course of the shareholders' relationship with the corporation and with each other."[285] As noted above, recent decisions have used the reasonable expectations of shareholders to interpret oppression.[286] A shareholder's reasonable expectations may provide the perspective from which a court can judge whether the acts of the controlling shareholders have been unfairly prejudicial.[287]

Again, difficulties with the interpretation exist. While a number of cases have addressed the analysis of a shareholder's reasonable expectations,[288] other courts have refused to consider a shareholder's reasonable expectations as broadly as subsection 10-19.1-115(3) apparently mandates.[289] More importantly, the description of the reasonable expectations of the shareholders provides no guidance for the application of the frameworks. Again, the two frameworks provide two perspectives. The first perspective applies the analysis of the intervention framework when the reasonable expectations of the shareholders are to be fulfilled, and a failure to do so constitutes oppression or unfairly prejudicial conduct.[290] Under the intervention framework, it is irrelevant whether the controlling shareholders' actions were the result of a

284. *See supra* notes 231-44 and accompanying text.

285. N.D. CENT. CODE § 10-19.1-115(3) (1985).

286. *See, e.g.*, Exadaktilos v. Cinnaminson Realty Co., 167 N.J. Super. 141, 400 A.2d 554 (N.J. Super. Ct. Law Div. 1979), *aff'd per curiam*, 173 N.J. Super. 559, 414 A.2d 994 (N.J. Super. Ct. App. Div. 1980); *In re* Topper, 107 Misc. 2d 25, 433 N.Y.S.2d 359 (N.Y. Sup. Ct. 1980).

287. *See supra* notes 122-28 and accompanying text.

288. *See, e.g.*, Exadaktilos v. Cinnaminson Realty Co., 167 N.J. Super. 141, 400 A.2d 554 (N.J. Super. Ct. Law Div. 1979), *aff'd per curiam*, 173 N.J. Super. 559, 414 A.2d 994 (N.J. Super. Ct. App. Div. 1980); *In re* Topper, 107 Misc. 2d 25, 433 N.Y.S.2d 359 (N.Y. Sup. Ct. 1980); *see also* Peeples, *supra* note 20, at 501-06 (discussion of reasonable expectations approach and cases applying that approach).

289. Subsection 10-19.1-115(3) of the North Dakota Century Code requires that the court consider the reasonable expectations of the shareholders as they exist at the inception and develop during the course of the shareholders' relationship with each other. N.D. CENT. CODE § 10-19.1-115(3) (1985). *But see* Gimpel v. Bolstein, 125 Misc. 2d 45, 477 N.Y.S.2d 1014 (N.Y. Sup. Ct. 1984). In *Gimpel*, the court found the reasonable expectations approach inappropriate when the corporation is in an advanced stage of existence. *Id.* at ____, 477 N.Y.S.2d at 1019. The court noted that when shareholders acquire their interest by bequest or gift from other parties, they do not choose to be business associates and thus are unlike partners in an incorporated partnership. *Id.* Establishing reasonable expectations becomes very difficult in such a situation. *Id.*

290. *See supra* notes 140-46 and accompanying text.

valid exercise of business judgment.[291] The second perspective applies the analysis of the nonintervention framework. Under this perspective, the frustration of a shareholder's reasonable expectations does not necessarily equal unfairly prejudicial conduct. If the controlling shareholders were justified in taking the actions that caused the frustration of the shareholder's reasonable expectations, no relief is available.[292]

With respect to both of the considerations that the court will apply to determine what conduct is unfairly prejudicial, a choice between two perspectives exists. The choice of which perspective to apply is political. One perspective is no more correct than the other.[293] A court may justify intervention with reference to one framework or justify nonintervention with reference to the other.

Because of the relatively short time the Minnesota amendments have been in place, little guidance can be obtained from Minnesota decisions. One district court decision, however, deserves comment. In *Frenzel v. Logisticks, Inc.*,[294] the minority shareholders in a group of related closely held corporations sued the controlling shareholders and corporations for, among other things, several breaches of fiduciary duty.[295] In its findings of fact, the court found that the controlling shareholders had eliminated cumulative voting, paid only the minimum amount of dividends required to avoid penalty, and attempted to freeze-out the plaintiffs by making unfairly low offers for their stock.[296] In addition, the controlling shareholders had commingled their personal business ventures with the affairs of the corporation and engaged in various activities that represented a conflict of interest.[297] After noting the existence of the controlling shareholders' fiduciary duty to the minority shareholders,[298] the court concluded that the acts of the controlling shareholders were fraudulent, illegal, and unfairly prejudicial in violation of the Minnesota statute.[299] The court

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291. *See, e.g., In re* Topper, 107 Misc. 2d 25, ____, 433 N.Y.S.2d 359, 362 (N.Y. Sup. Ct. 1980). For a discussion of the reasonable expectations approach, see *supra* notes 147-49 and accompanying text.

292. *See. e.g.,* Exadaktilos v. Cinnaminson Realty Co., 167 N.J. Super. 141, ____, 400 A.2d 554, 561-62 (N.J. Super. Ct. Law Div. 1979), *aff'd per curiam,* 173 N.J. Super. 559, 414 A.2d 994 (N.J. Super. Ct. App. Div. 1980). For a discussion of this approach, see *supra* notes 246-53 and accompanying text.

293. *See supra* note 17.

294. File No. 457733 (Minn. Dist. Ct., Ramsey County, Oct. 31, 1985).

295. *See* Frenzel v. Logisticks, Inc., File No. 457733, findings of fact, conclusions of law, and order for judgment at 91-94 (Minn. Dist. Ct., Ramsey County, Oct. 31, 1985).

296. *Id.* at 91-92.

297. *Id.* at 91-92, 95-96.

298. *Id.* at 99.

299. *Id.* at 100.

ordered dissolution of the corporations and liquidation of their assets.[300]

Although *Frenzel* stands as an example of a court intervening to protect the minority shareholders, it sheds little light on the provisions of the statute. Because the activities of the controlling shareholders were both illegal and fraudulent, as well as unfairly prejudicial, relief would have been justified under a much narrower statute.

The tension that exists between the two frameworks is not resolved by North Dakota's involuntary dissolution statute. That tension allows the courts to exercise a great deal of flexibility in dealing with the problems of the closely held corporation. A court's decision, whether to intervene to protect the rights of minority shareholders or not to intervene, thereby insulating the decisions of the controlling shareholders, may be justified by reference to the appropriate framework. The statute itself does nothing more than direct the inquiry. The result of a court's inquiry is dependent upon which framework it chooses to apply.

VI. CONCLUSION

This Article does not claim to set out the one appropriate analysis of the new North Dakota involuntary dissolution statute. Rather, it attempts to provide possible structures within which corporate behavior may be judged. If protection of minority shareholders is the goal, counsel should employ the intervention framework. The argument should be framed so that a violation of the controlling shareholders' fiduciary duty, or the frustration of a minority shareholder's reasonable expectations constitutes oppression or unfairly prejudicial conduct, without reference to the reasons for the controlling shareholders' acts. If protection of the directors' and controlling shareholders' acts is the goal, counsel should employ the nonintervention framework. The argument should be framed so that the directors and controlling shareholders are allowed to exercise their business judgment and to operate the business in the manner that they deem is in the best interests of the corporation. The choice of the goal will determine the analysis and the outcome.

300. *Id.* at 102-04. After judgment was ordered, the controlling shareholders bought out the minority shareholders, thereby preventing dissolution of the corporations. *See* Minneapolis Star and Tribune, Nov. 23, 1985, at 9B, col. 6.