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Shareholder Oppression in Close Corporations: the Unanswered Question of Perspective

Douglas K. Moll

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Shareholder Oppression in Close Corporations: The Unanswered Question of Perspective

Douglas K. Moll

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I. INTRODUCTION

The doctrine of shareholder oppression protects the close corporation minority stockholder from the improper exercise of majority control.¹ Nevertheless, when a close corporation minority shareholder

1. The terms "majority shareholder" and "minority shareholder" (or "majority" and "minority") are used in this Article "to distinguish those shareholders who possess the actual power to control the operations of the firm from those who do not." J.A.C. Hetherington & Michael P.

asserts that the majority shareholder has acted "oppressively" towards him, the minority's chance of success may very well depend on the perspective from which shareholder oppression is viewed. Consider the following two decisions:

In *Priebe v. O'Malley*, the controlling shareholders of a close corporation terminated the employment of Myron Priebe, a minority shareholder, for "unsatisfactory" work performance.² Priebe sued, asserting that the termination amounted to oppressive conduct.³ The trial court noted that "Priebe was not producing sales and that he was not working well with other employees."⁴ As a consequence, the trial court found that the controlling shareholders had a "legitimate business purpose" for the termination.⁵ The *Priebe* court affirmed the denial of relief, observing that "[b]ased on this record, we cannot find that the majority lacked a legitimate business purpose for breaching its fiduciary duty to Priebe if, in fact, this duty was breached."⁶

In *Balvik v. Sylvester*, Elmer Balvik was the minority shareholder of a two-person close corporation.⁷ The majority shareholder openly questioned Balvik's job performance and ultimately terminated him as an employee of the company.⁸ Balvik sued, alleging in part that the majority shareholder was "guilty of oppression and malice by discharging him from employment with the corporation."⁹ Despite the majority's problems with Balvik's job performance, the court concluded that oppressive conduct had occurred:

We find little relevance in whether [the majority shareholder] discharged Balvik from employment for cause The ultimate effect of these actions is that Balvik clearly has been "frozen out" of a business in which he reasonably expected to participate. As a result, Balvik is entitled to relief.¹⁰

Dooley, *Illiquidity and Exploitation: A Proposed Statutory Solution to the Remaining Close Corporation Problem*, 63 VA. L. REV. 1, 5 n.7 (1977). Such power is most often determined by the size of the shareholdings. *See id.*

2. *See Priebe v. O'Malley*, 623 N.E.2d 573, 574-75 (Ohio Ct. App. 1993).

3. *See id.* at 575. Because Ohio defines oppressive conduct as the majority shareholder's breach of a heightened fiduciary duty owed to the minority shareholder, *see Crosby v. Beam*, 548 N.E.2d 217, 221 (Ohio 1989), the minority shareholder actually sued for breach of this fiduciary duty. *See Priebe*, 623 N.E.2d at 575; *see also infra* text accompanying note 60.

4. *Priebe*, 623 N.E.2d at 575. There was also evidence that "Priebe was converting corporate property to personal use, that he was not working full daily hours, and that he threatened to shut down the company." *Id.* at 575-76.

5. *Id.* at 575.

6. *Id.* at 576.

7. *See Balvik v. Sylvester*, 411 N.W.2d 383, 384 (N.D. 1987).

8. *See id.* at 384-85 & n.1. Aside from stating that the majority shareholder "also questioned Balvik's job performance," the opinion gives no further information on the performance problems that the majority perceived. *Id.* at 384.

9. *Id.* at 384-85.

10. *Id.* at 388 (emphasis added).

Although *Priebe* and *Balvik* arose in different jurisdictions, the cases share a number of factual similarities. In both cases, the employment of a minority shareholder was terminated. In both cases, the minority's poor job performance was cited as a justification for the termination. Finally, in both cases, the minority shareholder asserted that the discharge amounted to oppressive conduct. Despite these similarities, only the *Balvik* court granted relief.¹¹ In *Priebe*, the controlling shareholder's justification for the discharge greatly influenced the court's conclusion that no oppressive conduct had occurred. In *Balvik*, however, such a justification was essentially considered irrelevant to the court's oppression analysis and to its eventual conclusion that relief was warranted.¹²

What explains these different outcomes? Why is the majority's justification critical in *Priebe*, but not in *Balvik*? To answer these questions, one must recognize that the analyses of the *Priebe* and *Balvik* courts illustrate divergent approaches to the shareholder oppression doctrine. On the one hand, the *Priebe* court views shareholder oppression from a majority perspective—a perspective that focuses primarily on the propriety of the majority's conduct. On the other hand, the *Balvik* court views shareholder oppression from a minority perspective—a perspective that focuses primarily on the effect that majority conduct has on the minority. Whereas a majority-perspective court finds oppression liability when the majority's actions are not justified by a legitimate business purpose, a minority-perspective court generally finds oppression liability when majority actions, whether justified or not, harm the interests of a minority shareholder. Put differently, because the majority perspective focuses primarily on the propriety of the majority shareholder's conduct, the majority's justification for its actions is critical to an oppression analysis. Because the minority perspective focuses primarily on the effect of such majority conduct, however, the majority's justification is of little to no importance in the oppression analysis.¹³

11. Compare *Balvik*, 411 N.W.2d at 388 (granting relief), with *Priebe*, 623 N.E.2d at 576 (denying relief).

12. See *supra* text accompanying notes 4-6, 10. It is worth noting that the employment at will doctrine does not explain why relief from termination was granted in *Balvik* but not in *Priebe*. Indeed, because neither opinion mentioned an express or implied employment agreement, both *Balvik* and *Priebe* were likely at-will employees. See *infra* notes 28-30 and accompanying text (discussing the applicability of the employment at will doctrine to close corporation disputes).

13. See *infra* Part II.C. (discussing the majority and minority perspectives of shareholder oppression).

Despite this distinction, some courts and commentators have characterized the majority and minority perspectives as “not contradictory” and having “little difference” in practice.¹⁴ To be sure, these characterizations are entirely accurate for the “freeze-out” cases¹⁵ that typify the reported decisions on shareholder oppression.¹⁶ Indeed, the choice of oppression perspective makes very little difference in these extreme cases, as oppression liability will likely be found under either perspective.¹⁷ Cases outside the freeze-out context have arisen, however, and they will undoubtedly continue to arise as the oppression doctrine develops further.¹⁸ In such cases, the choice of oppression perspective plays a critical role. The *Priebe* and *Balvik* decisions, for example, illustrate that the success or failure of a shareholder oppression claim may turn entirely on whether a court views the oppression doctrine from a majority or minority perspective. It may be time, therefore, to move beyond the “not contradictory” and “little difference” characterizations, particularly because such characterizations may unintentionally suggest that the choice of perspective lacks importance. By moving to a more nuanced discussion of the distinctions between the perspectives, it becomes possible to focus on the virtues and drawbacks of the majority and minority approaches and to determine which of the competing views is superior.¹⁹

14. More precisely, some courts and commentators have described the oppression definitions that reflect the majority and minority perspectives as “not contradictory” and having “little difference” in practice. See, e.g., 2 F. HODGE O’NEAL & ROBERT B. THOMPSON, O’NEAL’S CLOSE CORPORATIONS § 9.29, at 132-33 (3d ed. 1994) [hereinafter O’NEAL, CLOSE CORPORATIONS] (“These three standards for determining oppression are not contradictory, as conduct that violates one of them may well also violate the others.”); 2 F. HODGE O’NEAL & ROBERT B. THOMPSON, O’NEAL’S OPPRESSION OF MINORITY SHAREHOLDERS § 7:13, at 80 (2d ed. 1985) [hereinafter O’NEAL, OPPRESSION] (same); Steven C. Bahls, *Resolving Shareholder Dissension: Selection of the Appropriate Equitable Remedy*, 15 J. CORP. L. 285, 322 (1990) (“Although courts focusing on the majority’s duty of utmost good faith and loyalty and courts focusing on the minority’s reasonable expectations do take different approaches, in practice, there is little difference.”); see also *Gimpel v. Bolstein*, 477 N.Y.S.2d 1014, 1019 (Sup. Ct. 1984) (observing that the various oppression formulations “will frequently be found to be equivalent”); *infra* text accompanying notes 59-62, 69-70 (describing the three principal approaches to defining oppression).

15. “Freeze-out” cases involve egregious majority conduct that is designed to deprive the blameless minority shareholder “of business income or advantages to which [the minority is] entitled.” 1 O’NEAL, OPPRESSION, *supra* note 14, § 1:01, at 1-2; see *infra* text accompanying notes 38-47 (describing a freeze-out); *infra* note 17.

16. See, e.g., *Landstrom v. Shaver*, 561 N.W.2d 1, 10 (S.D. 1997) (describing freeze-out situations as “typical of oppression cases”).

17. See *infra* Part IV.C.1. (describing the operation of the perspectives in the freeze-out context).

18. See *Landstrom*, 561 N.W.2d at 10 (“While freeze-out or squeeze-out situations may be typical of oppression cases, they are not exclusive.”).

19. Cf. Robert A. Ragazzo, *Toward a Delaware Common Law of Closely Held Corporations*, 78 WASH. U. L.Q. 1, 14 (2000) (noting that “there has been no cause to choose between the

This Article argues that the majority and minority perspectives do represent divergent approaches to the shareholder oppression doctrine. By exploring the operation of the perspectives in their “pure” and “modified” formulations, this Article contends that the choice of perspective can make an outcome-determinative difference in a number of cases. More importantly, however, this Article confronts the harder question that courts and commentators have not adequately considered—from which perspective *should* shareholder oppression be viewed? This Article maintains that the shareholder oppression doctrine should operate to protect the minority’s investment and to preserve, at least to some extent, the majority’s decision-making discretion. As a consequence, the Article concludes that the “modified” minority approach—an approach that incorporates both minority and majority interests—is the superior oppression perspective.²⁰

To reach this conclusion, hypothetical bargains between reasonable close corporation shareholders are constructed and informed assumptions about the results of those bargains are made. In so doing, the Article argues that the modified minority perspective is the only approach that enforces the likely understandings that reasonable investors would have reached if, at the venture’s inception, they had bargained over the protection of their investments and the prerogatives of the majority.²¹ Indeed, because the close corporation investment is typically comprised of more than a mere financial stake in the corporation’s success, this Article asserts that reasonable close corporation shareholders would not reach an understanding that *any* majority conduct benefiting the corporation is permissible.²² Courts should recognize, in other words, that the majority perspective of oppression is flawed due to its implicit assumption that reasonable close corporation shareholders are solely concerned with maximizing the profits of the business. Because the modified minority perspective recognizes that profitable and “legal” corporate conduct must be prohibited in certain circumstances, such a perspective is a superior approach to the shareholder oppression doctrine.

To put this Article in context, one should understand that “[c]lose corporations account for most of American business.”²³ Indeed,

competing [majority and minority] approaches” because “most litigated cases have been easy cases,” but suggesting that “[i]n hard cases, the distinction between the [majority and minority] conceptions of the majority’s fiduciary duty in the close corporation context might well be relevant”).

20. See *infra* Part V.

21. See *infra* Part V.C-D.

22. See *infra* notes 211-20 and accompanying text.

23. See Bahls, *supra* note 14, at 287.

"[f]amily-owned businesses alone represent ninety-five percent of all United States businesses and are responsible for nearly fifty percent of the jobs in the United States."²⁴ Moreover, the number of new business incorporations in this country has reached peak levels.²⁵ As a consequence, the issues discussed in this Article affect an enormous number of companies as well as individuals.

It is important to note that this Article discusses which approach to the shareholder oppression doctrine is superior. Whether the shareholder oppression doctrine should exist at all, however, is a separate question that is beyond the scope of this Article.²⁶ Moreover, because "[m]any would argue that the denial of employment [to a shareholder] is a classic example of oppression,"²⁷ and because numerous litigated cases involve shareholders challenging their terminations as oppressive, this Article will often use an employment discharge as an example of allegedly oppressive conduct. It bears mentioning, therefore, that in most close corporation disputes involving terminated shareholders, the employment at will doctrine²⁸ should not be viewed as a barrier to relief.²⁹ Indeed, the author has previously taken such a position and this Article proceeds on the assumption that the position is valid.³⁰

Part II of this Article provides needed background information by discussing the nature of the close corporation, the development of the shareholder oppression doctrine, and the defining characteristics

24. *Id.*

25. See U.S. SMALL BUS. ADMIN., SMALL BUSINESS ECONOMIC INDICATORS 18 (1998) ("[N]ew business incorporations are . . . at their peak record levels for the last ten years.").

26. One could argue that if close corporation shareholders do not contract for protection, they should be governed by traditional public corporation norms and not by a special close corporation doctrine. Such an argument, of course, challenges the basic legitimacy of the shareholder oppression doctrine and, consequently, is beyond the scope of this Article.

27. Robert W. Hillman, *The Dissatisfied Participant in the Solvent Business Venture: A Consideration of the Relevant Permanence of Partnerships and Close Corporations*, 67 MINN. L. REV. 1, 46 n.141 (1982); see also *id.* at 80 n.250 ("Few would deny that the denial of employment as a squeeze-out technique is 'oppressive' . . ."); *id.* at 78 ("The classic example of what, in a given situation, may be a substantial expectation is employment.").

28. In general, the employment at will doctrine "allows an employer to terminate an employee with or without just cause in the absence of an agreement limiting the employee's discharge to just cause or specifying the term of employment." Sandra L. Schlafge, Comment, *Pedro v. Pedro: Consequences for Closely Held Corporations and the At-Will Doctrine in Minnesota*, 76 MINN. L. REV. 1071, 1081 (1992) (footnote omitted).

29. See, e.g., Douglas K. Moll, *Shareholder Oppression v. Employment at Will in the Close Corporation: The Investment Model Solution*, 1999 U. ILL. L. REV. 517, 531 n.65 (citing cases where terminated shareholders were granted relief on oppression grounds with no mention of the employment at will doctrine).

30. See *id.* at 536-68 (arguing that the shareholder oppression doctrine can protect close corporation employment without intruding into the legitimate coverage of the employment at will rule).

of the majority and minority perspectives. Parts III and IV explore the distinctions between the perspectives by examining them in their "pure" and "modified" formulations. By considering the presence or absence of two variables—"majority fault"³¹ and "minority fault"³²—in varying combinations, these parts demonstrate that the perspectives reach different results when particular fact patterns are at issue. Finally, Part V argues that the "modified" minority approach is the superior oppression perspective given that it protects the minority's investment and preserves the majority's control in conformity with the likely understandings of the shareholders.

II. THE DOCTRINE OF SHAREHOLDER OPPRESSION

A. *The Nature of the Close Corporation*

A close corporation is a business organization typified by a small number of stockholders, the absence of a market for the corporation's stock, and substantial shareholder participation in the management of the corporation.³³ In the traditional public corporation, the shareholder is normally a detached investor who neither contributes

31. "Majority fault" is used in this Article to refer to the majority's lack of a legitimate business purpose for its allegedly oppressive actions. Conversely, the absence of majority fault indicates that the allegedly oppressive actions were supported by a legitimate business purpose.

32. "Minority fault" is used in this Article to refer to misconduct or incompetence on behalf of the minority shareholder (e.g., theft, failure to learn the business) that harms the corporation and that brings about the majority's allegedly oppressive actions (e.g., a termination of the minority's employment). If minority fault is present, it indicates that the minority shareholder is to blame in some manner for the challenged majority conduct. Conversely, if minority fault is absent, it indicates that the minority's own actions have not had any role in bringing about the challenged majority conduct.

33. See, e.g., *Donahue v. Rodd Electrotype Co.*, 328 N.E.2d 505, 511 (Mass. 1975); Daniel S. Kleinberger, *Why Not Good Faith? The Foibles of Fairness in the Law of Close Corporations*, 16 WM. MITCHELL L. REV. 1143, 1148 (1990) ("Close corporations have a limited number of shareholders, and most, if not all, of the shareholders are active in the corporation's day-to-day business.").

There is some variation in the definition of a close corporation. See WILLIAM L. CARY & MELVIN ARON EISENBERG, *CASES AND MATERIALS ON CORPORATIONS* 389 (7th ed. 1995) (unabridged) ("Exactly what constitutes a close corporation is often a matter of theoretical dispute. Some authorities emphasize the number of shareholders, some the lack of a market for the corporation's stock, and some the existence of formal restrictions on the transferability of the corporation's shares."); 1 O'NEAL, *CLOSE CORPORATIONS*, supra note 14, § 1.02, at 4-7 (noting the following possible definitions of a "close corporation": a corporation with relatively few shareholders; a corporation whose shares are not generally traded in the securities markets; a corporation in which the participants consider themselves partners inter se; a corporation in which management and ownership are substantially identical; and any corporation which elects to place itself in a close corporation grouping). Nevertheless, the typical close corporation possesses most, if not all, of the attributes described in these various definitions.

labor to the corporation nor takes part in management responsibilities.³⁴ In contrast, within a close corporation, "a more intimate and intense relationship exists between capital and labor."³⁵ Close corporation shareholders "usually expect employment and a meaningful role in management, as well as a return on the money paid for [their] shares."³⁶ Moreover, close corporation investors are often linked by family or other personal relationships that result in a familiarity between the participants.³⁷

Conventional corporate law norms of majority rule and centralized control can lead to serious problems for the close corporation minority shareholder.³⁸ Traditionally, most corporate power is centralized in the hands of a board of directors.³⁹ In a close corporation, the board is ordinarily controlled "by the shareholder or shareholders holding a majority of the voting power."⁴⁰ Through this control of the board, the majority shareholder has the ability to take actions that are harmful to the minority shareholder's interests. Such actions are often referred to as "freeze-out" or "squeeze-out" techniques⁴¹ that "oppress"⁴²

34. See 1 O'NEAL, *CLOSE CORPORATIONS*, *supra* note 14, § 1.08, at 31-32.

35. Robert B. Thompson, *The Shareholder's Cause of Action for Oppression*, 48 *BUS. LAW.* 699, 702 (1993).

36. *Id.*; see, e.g., *Pedro v. Pedro*, 463 N.W.2d 285, 289 (Minn. Ct. App. 1990) ("[T]he primary expectations of minority shareholders include an active voice in management of the corporation and input as an employee."); 1 O'NEAL, *CLOSE CORPORATIONS*, *supra* note 14, § 7.02, at 4 ("Ownership and management frequently coalesce in closely held corporations, where not uncommonly all the principal shareholders devote full time to corporate affairs. Even where one or two shareholders may be inactive, the business is normally conducted by the others without aid from nonshareholder managers."); *infra* notes 189-90 and accompanying text.

37. See Robert B. Thompson, *Corporate Dissolution and Shareholders' Reasonable Expectations*, 66 *WASH. U. L.Q.* 193, 196 (1988).

38. See 1 O'NEAL, *OPPRESSION*, *supra* note 14, § 1:02, at 3-4 (characterizing majority rule and centralized management as the "traditional pattern of corporate management," and noting the dangers that this management pattern presents to close corporation minority shareholders); Thompson, *supra* note 35, at 702-03 ("In a closed setting, the corporate norms of centralized control and majority rule easily can become instruments of oppression.").

39. See REVISED MODEL BUS. CORP. ACT § 8.01(b) (1993) [hereinafter *RMBCA*] ("All corporate powers shall be exercised by or under the authority of, and the business and affairs of the corporation managed under the direction of, its board of directors . . ."); Kleinberger, *supra* note 33, at 1152 ("In traditional theory, ultimate authority resides with the board of directors . . .").

40. Kleinberger, *supra* note 33, at 1151-52; see also 1 O'NEAL, *OPPRESSION*, *supra* note 14, § 1:02, at 3 ("Indeed, in most closely held corporations, majority shareholders elect themselves and their relatives to all or most of the positions on the board.").

41. See 1 O'NEAL, *OPPRESSION*, *supra* note 14, § 1:01, at 3 n.2 ("The term 'freeze-out' is often used as a synonym for 'squeeze-out.'"). It has been noted that the term "squeeze-out" means "the use by some of the owners or participants in a business enterprise of strategic position, inside information, or powers of control, or the utilization of some legal device or technique, to eliminate from the enterprise one or more of its owners or participants." *Id.* at 1. Similarly, a "partial squeeze-out" is defined as "action which reduces the participation or powers of a group of participants in the enterprise, diminishes their claim on earnings or assets, or otherwise deprives them of business income or advantages to which they are entitled." *Id.* at 1-2. See generally 1 O'NEAL,

the close corporation minority shareholder. Common freeze-out techniques include the termination of a minority shareholder's employment, the refusal to declare dividends, the removal of a minority shareholder from a position of management, and the siphoning off of corporate earnings through high compensation to the majority shareholder.⁴³ Quite often, these tactics are used in combination. For example, the close corporation investor typically looks to salary rather than dividends for a share of the business returns because the "[e]arnings of a close corporation often are distributed in major part in salaries, bonuses and retirement benefits."⁴⁴ When actual dividends are not paid, therefore, a minority shareholder who is discharged from employment and removed from the board of directors is effectively denied any return on his investment as well as any input into the management of the business.⁴⁵ Once the minority shareholder is faced with this "indefinite future with no return on the capital he or she contributed to the enterprise,"⁴⁶ the majority often proposes to purchase the shares of the minority shareholder at an unfairly low price.⁴⁷

OPPRESSION, *supra* note 14, §§ 3:01-3:20, 4:01-4:08, 5:01-5:39 (discussing various squeeze-out techniques); 2 O'NEAL, OPPRESSION, *supra* note 14, §§ 6:01-6:10 (same).

42. See *infra* text accompanying notes 59-61 (describing judicial definitions of "oppression").

43. See 1 O'NEAL, OPPRESSION, *supra* note 14, §§ 3:04, 3:06, 3:07, at 18-21, 44-50, 66-68; see also *Donahue v. Rodd Electrotype Co.*, 328 N.E.2d 505, 513 (Mass. 1975) (noting some of the possible freeze-out techniques).

44. 1 O'NEAL, CLOSE CORPORATIONS, *supra* note 14, § 1.08, at 32; see Kleinberger, *supra* note 33, at 1148 ("Payout is frequently in the form of salary rather than dividends.").

Reasonable salaries paid to employees of a close corporation can be deducted by the close corporation when calculating its taxable income "and will thereby reduce the amount of income tax that the company pays." Thompson, *supra* note 37, at 197 n.12 (citing I.R.C. § 162). Dividends paid to close corporation shareholders, however, cannot be deducted by the corporation. As a consequence, corporate income paid as dividends is subject to double taxation—once as business income at the corporate level, and once as personal income at the shareholder level. See *id.* Because of the tax system's discouragement of dividends in favor of salaries, "most close corporations provide a return to participants in the form of salary or other employee-related benefits." Thompson, *supra* note 35, at 714 n.90; see also 1 O'NEAL, OPPRESSION, *supra* note 14, § 1:03, at 4-5 ("[A] close corporation, in order to avoid so-called 'double taxation,' usually pays out most of its earnings in the form of salaries rather than as dividends.").

45. See, e.g., *Balvik v. Sylvester*, 411 N.W.2d 383, 388 (N.D. 1987) ("Balvik was ultimately fired as an employee of the corporation, thus destroying the primary mode of return on his investment. Any slim hope of gaining a return on his investment and remaining involved in the operations of the business was dashed when Sylvester removed Balvik as a director and officer of the corporation."); 1 O'NEAL, CLOSE CORPORATIONS, *supra* note 14, § 1.15, at 89 ("An investor taking a minority investment position in a close corporation, expecting to receive a return on the investment in the form of a regular salary, would face the risk that, after a falling out among the participants, the directors would terminate the minority shareholder's employment and deprive that investor of any return on the investment in the corporation.").

46. Thompson, *supra* note 35, at 703; see 1 O'NEAL, CLOSE CORPORATIONS, *supra* note 14, § 1.16, at 96 ("If, for example, the minority shareholder is fired from the employment that was providing the return on the investment in the close corporation, the minority may face an

In the public corporation, the minority shareholder can escape these abuses of power by simply selling his shares on the market. By definition, however, there is no ready market for the stock of a close corporation.⁴⁸ Thus, when a close corporation shareholder is treated unfairly through termination or otherwise, the investor "cannot escape the unfairness simply by selling out at a fair price."⁴⁹

B. The Cause of Action for Oppression

Over the years, state legislatures and courts have developed two significant avenues of relief for the "oppressed" close corporation shareholder. First, many state legislatures have amended their corporate dissolution statutes to include "oppression" by the controlling shareholder as a ground for involuntary dissolution of the corporation.⁵⁰ Moreover, when oppressive conduct has occurred, actual dissolution is not the only remedy at the court's disposal. Both state statutes and judicial precedents have authorized alternative remedies

indefinite period with no return on the investment."); Charles W. Murdock, *The Evolution of Effective Remedies for Minority Shareholders and Its Impact Upon Valuation of Minority Shares*, 65 NOTRE DAME L. REV. 425, 447 (1990) ("[T]he primary vulnerability of a minority shareholder is the spectre of being 'locked-in,' that is, having a perpetual investment in an entity without any expectation of ever receiving a return on that investment.").

47. See, e.g., *Donahue v. Rodd Electrotype Co.*, 328 N.E.2d 505, 515 (Mass. 1975) ("Majority 'freeze-out' schemes which withhold dividends are designed to compel the minority to relinquish stock at inadequate prices. When the minority stockholder agrees to sell out at less than fair value, the majority has won." (citations omitted)); 2 O'NEAL, *CLOSE CORPORATIONS*, *supra* note 14, § 8.13, at 68 (noting that "[a] squeeze out usually does not offer fair payment to the 'squeezes' for the interests, rights or powers which they lose"); Thompson, *supra* note 35, at 703-04 (noting that in a classic freeze-out, "the majority first denies the minority shareholder any return and then proposes to buy the shares at a very low price").

48. See *Donahue*, 328 N.E.2d at 514 ("In a large public corporation, the oppressed or dissident minority stockholder could sell his stock in order to extricate some of his invested capital. By definition, this market is not available for shares in the close corporation."); *Brenner v. Berkowitz*, 634 A.2d 1019, 1027 (N.J. 1993) ("[U]nlike shareholders in larger corporations, minority shareholders in a close corporation cannot readily sell their shares when they become dissatisfied with the management of the corporation."); 2 O'NEAL, *CLOSE CORPORATIONS*, *supra* note 14, § 9.02, at 4 ("[A] shareholder in a close corporation does not have the exit option available to a shareholder in a publicly held corporation, who can sell his shares in a securities market if he is dissatisfied with the way the corporation is being operated."); Thompson, *supra* note 35, at 703 ("[T]he economic reality of no public market deprives investors in close corporations of the same liquidity and ability to adapt available to investors in public corporations."); see also FRANK H. EASTERBROOK & DANIEL R. FISCHER, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 230-31 (1991) (noting that "the lack of an active market in shares" prohibits close corporation shareholders from creating "homemade dividends" by selling stock).

49. Kleinberger, *supra* note 33, at 1149.

50. See Thompson, *supra* note 35, at 708-09 & n.70. See generally Murdock, *supra* note 46, at 452-61 (describing the development of oppression as a ground for dissolution).

that are less drastic than dissolution.⁵¹ As the alternative forms of relief have broadened over the years, orders of actual dissolution have become less frequent.⁵² Thus, "oppression" has evolved from a statutory ground for involuntary dissolution to a statutory ground for a wide variety of relief.⁵³

Second, particularly in states without an oppression-triggered dissolution statute, some courts have imposed an enhanced fiduciary duty between close corporation shareholders and have allowed an oppressed shareholder to bring a direct cause of action for breach of this duty.⁵⁴ In the seminal decision of *Donahue v. Rodd Electrotype Co.*, the Massachusetts Supreme Judicial Court adopted such a fiduciary duty along with a pro-minority "equal opportunity" rule:

The controlling group may not, consistent with its strict duty to the minority, utilize its control of the corporation to obtain special advantages and disproportionate benefit from its share ownership.

. . .

51. See, e.g., MINN. STAT. ANN. § 302A.751 subd. 1 (West Supp. 2000) (authorizing any equitable relief and specifically authorizing a buyout of the shareholder's interest); N.J. STAT. ANN. § 14A:12-7 (West Supp. 1999) (providing a nonexclusive list of possible relief that includes the order of a buyout and the appointment of a provisional director or custodian); *Brenner*, 634 A.2d at 1033 ("Importantly, courts are not limited to the statutory remedies [for oppression], but have a wide array of equitable remedies available to them."); *Balvik v. Sylvester*, 411 N.W.2d 383, 388-89 (N.D. 1987) (listing alternative forms of relief for oppressive conduct such as appointing a receiver, granting a buyout, and ordering the declaration of a dividend); *Masinter v. Webco Co.*, 262 S.E.2d 433, 441 & n.12 (W. Va. 1980) (listing ten possible forms of relief for oppressive conduct such as ordering the reduction of excessive salaries and issuing an injunction against further oppressive acts). But see *Giannotti v. Hamway*, 387 S.E.2d 725, 733 (Va. 1990) (stating that the dissolution remedy for oppression is "exclusive" and concluding that the trial court is not permitted "to fashion other . . . equitable remedies").

52. See *Thompson*, *supra* note 35, at 708; cf. Harry J. Haynsworth, *The Effectiveness of Involuntary Dissolution Suits as a Remedy for Close Corporation Dissension*, 35 CLEV. ST. L. REV. 25, 53 (1987) (finding that courts ordered remedies other than dissolution in the majority of 37 involuntary dissolution cases studied). See generally *Murdock*, *supra* note 46, at 461-64 (discussing the development of alternative remedies).

53. See 2 O'NEAL, CLOSE CORPORATIONS, *supra* note 14, § 9.29, at 132 ("The inclusion of 'oppression' and similar grounds as a basis for involuntary dissolution or alternative remedies has opened up a much broader avenue of relief for minority shareholders caught in a close corporation wracked with dissension."); *Thompson*, *supra* note 35, at 708-09 ("[I]t makes more sense to view oppression not as a ground for dissolution, but as a remedy for shareholder dissension.")

54. See *Thompson*, *supra* note 35, at 726; see also *id.* at 739 ("It should not be surprising that the direct cause of action is developed particularly in states without an oppression statute, and [it] provides a vehicle for relief for minority shareholders in a close corporation where the statutory norms reflect no consideration for the special needs of such enterprises."). See generally *Murdock*, *supra* note 46, at 433-40 (discussing the development of the shareholder fiduciary duty).

We hold 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.⁵⁵

The development of the statutory cause of action and the enhanced fiduciary duty reflect “the same underlying concerns for the position of minority shareholders, particularly in close corporations after harmony no longer reigns.”⁵⁶ Because of the similarities between the two remedial schemes, it has been suggested that “it makes sense to think of them as two manifestations of a minority shareholder’s cause of action for oppression.”⁵⁷ In the close corporation context, therefore, it is sensible to view the parallel development of the statutory cause of action and the enhanced fiduciary duty action as two sides of the same coin—i.e., the shareholder’s cause of action for oppression.

C. Viewing Oppression from Majority and Minority Perspectives

The development of a cause of action for oppression gives rise to a difficult question for courts: when has oppressive conduct occurred? Such an inquiry is complicated because of the competing concerns present in all oppression lawsuits—i.e., the need to protect minority shareholders and the desire to preserve majority discretion.⁵⁸ In wrestling with these concerns, the courts have developed three principal approaches to defining oppression. First, some courts define oppression as “burdensome, harsh and wrongful conduct . . . 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

55. *Donahue v. Rodd Electrotype Co.*, 328 N.E.2d 505, 515, 518-19 (Mass. 1975); *see also* *Crosby v. Beam*, 548 N.E.2d 217, 221 (Ohio 1989) (“Majority or controlling shareholders breach such fiduciary duty to minority shareholders when control of the close corporation is utilized to prevent the minority from having an equal opportunity in the corporation.”).

It should be noted that the *Donahue* “equal opportunity” rule was later scaled back by the same court. *See, e.g., Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657, 663 (Mass. 1976) (stating that allegedly oppressive conduct does not constitute a breach of fiduciary duty if the controlling group “can demonstrate a legitimate business purpose for its action”); *infra* notes 66-68 and accompanying text.

56. Thompson, *supra* note 35, at 739.

57. *Id.* at 700. *See generally id.* at 738-45 (describing the “combined cause of action for oppression”).

58. *See, e.g., Gabhart v. Gabhart*, 370 N.E.2d 345, 353-54 (Ind. 1977) (“On the one hand is the necessity to provide adequate protection for the interests and expectations of minority shareholders, and the other is the necessity of allowing sufficient corporate flexibility, as is required by modern commerce.”); *Wilkes*, 353 N.E.2d at 663 (“The majority, concededly, have certain rights to what has been termed ‘selfish ownership’ in the corporation which should be balanced against the concept of their fiduciary obligation to the minority.”).

is entitled to rely.’”⁵⁹ Second, some courts link oppression to breach of an enhanced fiduciary duty owed from one close corporation shareholder to another.⁶⁰ Third, some courts give meaning to oppression by equating it with conduct that “defeats the ‘reasonable expectations’ held by minority shareholders in committing their capital to the particular enterprise.”⁶¹

The formulation of these definitional approaches reveals a distinction in the perspective from which shareholder oppression is viewed. Both the “wrongful conduct” and “fiduciary duty” approaches define oppression from a “majority” perspective by linking the oppression analysis primarily to the propriety of the majority shareholder’s conduct.⁶² If the majority’s conduct is sufficiently improper to be characterized as wrongful or a breach of fiduciary duty, a finding of oppression is warranted. Of course, “proper” majority conduct, standing alone, is a term without meaning. Accordingly, majority perspective courts have generally linked proper majority conduct to actions that are justified by a legitimate business purpose.⁶³ The majority perspective of oppression, therefore, focuses on preserving the majority’s discretion to make decisions in furtherance of a legitimate business purpose—a standard that is typically satisfied when majority actions benefit the corporation.⁶⁴ Correspondingly, however, the majority

59. Thompson, *supra* note 35, at 711-12 (alteration in original) (quoting *Fix v. Fix Material Co.*, 538 S.W.2d 351, 358 (Mo. Ct. App. 1976)); *see, e.g.*, *Skierka v. Skierka Bros., Inc.*, 629 P.2d 214, 221 (Mont. 1981); *see also* Haynsworth, *supra* note 52, at 36-39 (describing judicial definitions of oppression).

60. *See, e.g.*, *supra* notes 54-55 and accompanying text.

61. *In re Kemp & Beatley, Inc.*, 473 N.E.2d 1173, 1179 (N.Y. 1984); *see* 2 O’NEAL, CLOSE CORPORATIONS, *supra* note 14, § 9.29, at 132; *see also infra* note 70.

62. *See* Hillman, *supra* note 27, at 45 (describing the “wrongful conduct” approach as “a traditional approach under which severe misconduct [of the majority shareholder] is required for a finding of oppression” (footnote omitted)); *id.* at 49 (noting that the “wrongful conduct” approach is “consistent with a reluctance to grant relief unless the conduct of those in control is sufficiently overreaching that it warrants ‘punishment’”); *infra* notes 66-67 and accompanying text.

63. *See, e.g.*, *Wilkes*, 353 N.E.2d at 663 (stating that allegedly oppressive action does not constitute a breach of fiduciary duty if the controlling group “can demonstrate a legitimate business purpose for its action”); *Masinter v. Webco Co.*, 262 S.E.2d 433, 440-41 (W. Va. 1980) (citing the “wrongful conduct” definition and suggesting that conduct justified by a “legitimate business purpose” is not oppressive).

64. *See, e.g.*, *A.W. Chesterton Co. v. Chesterton*, 128 F.3d 1, 7 (1st Cir. 1997) (“[A] ‘legitimate business purpose’ must be a legitimate purpose for the corporation.” (emphasis omitted)); *Zimmerman v. Bogoff*, 524 N.E.2d 849, 854 (Mass. 1988) (linking a legitimate business purpose to a “legitimate corporate purpose”); *Coggins v. New England Patriots Football Club, Inc.*, 492 N.E.2d 1112, 1118-19, 1122 (Mass. 1986) (linking a legitimate business purpose to a “valid corporate purpose” and to action that “further[ed] the interests of the corporation”).

perspective is somewhat less concerned with the protection of the minority shareholder.⁶⁵

One of the more significant decisions to express a majority perspective of oppression is *Wilkes v. Springside Nursing Home, Inc.*⁶⁶ In *Wilkes*, the Supreme Judicial Court of Massachusetts scaled back the *Donahue* fiduciary duty and suggested an oppression framework that linked the doctrine directly to the propriety of the majority's conduct and to the issue of a legitimate business purpose:

[W]hen minority stockholders in a close corporation bring suit against the majority alleging a breach of the strict good faith duty owed to them by the majority, we must carefully analyze the action taken by the controlling stockholders in the individual case. It must be asked whether the controlling group can demonstrate a legitimate business purpose for its action.⁶⁷

Moreover, the court's language echoed the majority perspective's emphasis on preserving the controlling shareholder's decision-making discretion:

[W]e are concerned that untempered application of the strict good faith standard enunciated in *Donahue* . . . will result in the imposition of limitations on legitimate action by the controlling group in a close corporation which will unduly hamper its effectiveness in managing the corporation in the best interests of all concerned. . . . [W]e acknowledge the fact that the controlling group in a close corporation must have some room to maneuver in establishing the business policy of the corporation. It 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.⁶⁸

65. See, e.g., Hillman, *supra* note 27, at 49 ("The traditional approach to the concept of oppression . . . focuses more on the character of the actions by those in control than it does on the impact that those actions may have on minority shareholders."); cf. Bahls, *supra* note 14, at 322 ("Historically, courts did not focus as sharply on the reasonable expectations of minority shareholders, but focused instead on wrongful conduct of the majority shareholders."); Hetherington & Dooley, *supra* note 1, at 11 ("[A] broad spectrum of management conduct may not be sufficiently culpable to constitute grounds [for dissolution] under the statute, even though the minority finds such conduct sufficiently objectionable to make it want to terminate its investment." (footnote omitted)).

66. *Wilkes*, 353 N.E.2d 657.

67. *Id.* at 663.

68. *Id.*; see also *Chesterton*, 128 F.3d at 7 (noting that the legitimate business purpose defense established by *Wilkes* was intended to protect "business discretion").

There is some question as to whether *Wilkes* can be characterized as a decision that reflects a greater concern with managerial discretion than minority protection. Indeed, the *Wilkes* court also noted that when the majority asserts a legitimate business purpose for its allegedly oppressive conduct, "it is open to minority stockholders to demonstrate that the same legitimate objective could have been achieved through an alternative course of action *less harmful to the minority's interest.*" *Wilkes*, 353 N.E.2d at 663 (emphasis added). Although this language is potentially significant, it is unlikely that it will be construed to favor minority interests over majority prerogatives. See *infra* Part IV.A.; *infra* notes 234-41 and accompanying text.

A very different perspective of oppression, however, focuses the analysis not on the propriety of the majority's conduct, but on the impact that majority actions have on the minority. This "minority" perspective emphasizes protecting the interests of the minority shareholders over preserving the discretion of the controlling group. The "reasonable expectations" approach exemplifies such a minority perspective⁶⁹ by linking oppression to majority conduct that frustrates the reasonable expectations held by a minority shareholder at the time he decided to join the venture.⁷⁰ Indeed, in describing the reasonable expectations standard, the New York Court of Appeals focused primarily on the harm to minority shareholders that potentially results from majority action:

A shareholder who reasonably expected that ownership in the corporation would entitle him or her to a job, a share of corporate earnings, a place in corporate management, or some other form of security, would be oppressed in a very real sense when others in the corporation seek to defeat those expectations and there exists no effective means of salvaging the investment.

. . .

69. See, e.g., Hillman, *supra* note 27, at 49-50 (observing that an oppression approach that focuses on the impact of majority actions upon minority shareholders "is probably best defined in terms of the reasonable expectations of the minority shareholders in the particular circumstances at hand") (quoting Allen B. Afterman, *Statutory Protection for Oppressed Minority Shareholders: A Model for Reform*, 55 VA. L. REV. 1043, 1063 (1969)); Ralph A. Peeples, *The Use and Misuse of the Business Judgment Rule in the Close Corporation*, 60 NOTRE DAME L. REV. 456, 504 (1985) (observing that the reasonable expectations analysis "[c]hannel[s] the inquiry away from assessing fault"); Thompson, *supra* note 37, at 219-20 ("The increasing use of the reasonable expectations standard reflects a move away from an exclusive search for egregious conduct by those in control of the enterprise and toward greater consideration of the effect of conduct on the complaining shareholder, even if no egregious conduct by controllers can be shown."); *id.* at 210 ("The increasing legislative and judicial tendency to define oppression by reference to the reasonable expectations of shareholders . . . [has] pushed the focus of the dissolution remedy beyond fault of the controlling shareholders."); see also Brenner v. Berkowitz, 634 A.2d 1019, 1029 (N.J. 1993) ("Focusing on the harm to the minority shareholder reflects a departure from the traditional focus, which was solely on the wrongdoing by those in control, and reflects the current trend of recognizing the special nature of close corporations.").

70. See *supra* text accompanying note 61; see also *In re Kemp & Beatley, Inc.*, 473 N.E.2d 1173, 1179 (N.Y. 1984) (noting that oppression liability can arise when expectations that were "central to the petitioner's decision to join the venture" are defeated); *In re Burack*, 524 N.Y.S.2d 457, 459 (App. Div. 1988) (same).

Some commentators caution that a reasonable expectations inquiry should look "to the shareholders' reasonable expectations as they existed at the inception of the enterprise . . . and as they developed thereafter through a course of dealing." 2 O'NEAL, CLOSE CORPORATIONS, *supra* note 14, § 9.30, at 143. It is conceded, however, that primary emphasis should be on the "participants' original business bargain" because "the most significant bargaining occurs at the initial stage of the enterprise." 2 O'NEAL, OPPRESSION, *supra* note 14, § 7:15, at 91; see Thompson, *supra* note 37, at 218.

[O]ppression should be deemed to arise . . . when the majority conduct substantially defeats expectations that, objectively viewed, were both reasonable under the circumstances and were central to the petitioner's decision to join the venture.⁷¹

Thus, the principal definitions of oppression used by the courts reflect two distinct perspectives of oppression. Whereas the majority perspective focuses primarily on the *conduct* of the majority shareholder, the minority perspective focuses primarily on the *effect* of that conduct on the minority shareholder.⁷² Determining whether the majority's conduct was proper and in furtherance of a legitimate business purpose is central to the majority perspective of oppression. In contrast, determining whether the minority's expectations were harmed is central to the minority perspective of oppression.⁷³

It should be noted that this discussion has provided only generic descriptions of the majority and minority perspectives. The pure and modified formulations of the perspectives, however, are more nuanced than these generic descriptions suggest. Indeed, the formulations greatly differ in the degree to which they consider majority and minority interests. To fully appreciate these differences, the formulations will require more particularized descriptions.

III. DISTINCTIONS BETWEEN THE "PURE" PERSPECTIVES OF SHAREHOLDER OPPRESSION

It is a useful starting point to consider the majority and minority perspectives of oppression in their extreme or "pure" formulations that have been suggested by some judicial decisions.

71. *Kemp*, 473 N.E.2d at 1179; see also Lawrence E. Mitchell, *The Death of Fiduciary Duty in Close Corporations*, 138 U. PA. L. REV. 1675, 1727 (1990) (observing that the reasonable expectations approach "focus[es] on minority interests").

72. See, e.g., *Meiselman v. Meiselman*, 307 S.E.2d 551, 566-67 (N.C. 1983) (finding that the trial court erroneously adopted a majority perspective by focusing "on any possible egregious wrongdoing" by the majority shareholder, and noting that a proper minority perspective would inquire into whether the "rights or interests" of the minority shareholder "are in need of protection").

73. It is important to note that the perspective from which oppression is viewed is not always identifiable from the definitions used by a court. Indeed, some courts cite both majority-perspective and minority-perspective definitions of oppression in their opinions. See, e.g., *Balvik v. Sylvester*, 411 N.W.2d 383, 387-88 (N.D. 1987) (citing the fiduciary duty and reasonable expectations definitions); *Jorgensen v. Water Works, Inc.*, 582 N.W.2d 98, 107 & n.10 (Wis. Ct. App. 1998) (citing the wrongful conduct, fiduciary duty, and reasonable expectations definitions, and noting that "[w]e view the broad 'burdensome, harsh and wrongful conduct' definition we have adopted as including consideration of the frustration of the reasonable expectations of shareholders, when that is appropriate"); see also Thompson, *supra* note 35, at 711 (observing that "courts have used at least three phrasings [of oppression], sometimes in combination"); *supra* text accompanying notes 59-61.

A. The Pure Majority Perspective

The pure majority perspective of oppression concerns itself solely with the propriety of the majority's conduct. Under such a perspective, the majority's justification for its actions plays the pivotal role, as conduct justified by a legitimate business purpose is protected from judicial sanction.⁷⁴ In contrast, the detrimental effects of majority conduct on minority interests are of no relevance to a pure majority court.⁷⁵ Minority interests, in other words, are not considered at all.

The decision of *Zidell v. Zidell, Inc.* nicely exemplifies the pure majority perspective of oppression.⁷⁶ In *Zidell*, a non-employee minority shareholder asserted that the controlling group was distributing "unreasonably small" dividends while corporate salaries and bonuses were increasing substantially.⁷⁷ The minority shareholder argued that the controlling group was making a "concerted effort . . . to wrongfully deprive him of his right to a fair proportion of the profits of the business."⁷⁸ Although agreeing that the minority shareholder had shown "factors [that] are often present in cases of oppression or attempted squeeze-out by majority shareholders," the court showed a lack of concern for the minority's position by declining to take action.⁷⁹ Instead, the court accepted the defendants' justification for the conservative dividend policy and refused to award relief.⁸⁰ As the court stated, "[i]f there are plausible business reasons supportive of the decision of the board of directors, and such reasons can be given credence, a

74. See, e.g., *Crosby v. Beam*, 548 N.E.2d 217, 221 (Ohio 1989) ("Where majority or controlling shareholders in a close corporation breach their heightened fiduciary duty to minority shareholders by utilizing their majority control of the corporation to their own advantage, without providing minority shareholders with an equal opportunity to benefit, such breach, absent a legitimate business purpose, is actionable." (emphasis added)); *Zidell v. Zidell, Inc.*, 560 P.2d 1086, 1089 (Or. 1977) ("[T]hose in control of corporate affairs have fiduciary duties of good faith and fair dealing toward the minority shareholders [T]hat duty is discharged if the decision is made in good faith and reflects legitimate business purposes rather than the private interests of those in control.").

75. See, e.g., *Mitchell*, *supra* note 71, at 1716 (noting that cases "concede that legitimate business reasons for the complained-of conduct would immunize the controlling interests from liability, even though the conduct resulted in harm to the beneficiary or disproportionate benefit to the fiduciary"); F. Hodge O'Neal, *Oppression of Minority Shareholders: Protecting Minority Rights*, 35 CLEV. ST. L. REV. 121, 125 (1987) (noting that "many courts apparently feel that there is a legitimate sphere in which the controlling (directors or) shareholders can act in their own interest even if the minority suffers").

76. See *Zidell v. Zidell, Inc.*, 560 P.2d 1086, 1089-90 (Or. 1977).

77. *Id.* at 1087-88.

78. *Id.* at 1088.

79. *Id.* at 1089-90.

80. See *id.* at 1090. The court noted that "[d]efendants introduced a considerable amount of credible evidence to explain their conservative dividend policy," and the court cited numerous corporate "needs" that required the retention of company earnings. *Id.*

Court will not interfere with a corporate board's right to make that decision.'⁸¹

As *Zidell* illustrates, the pure majority perspective emphasizes preserving the majority's decision-making discretion and exhibits no concern for the minority's position. Even if minority interests are harmed, oppression relief will be denied as long as the majority's conduct is justified by a legitimate business purpose.⁸²

B. The Pure Minority Perspective

In contrast to the pure majority perspective, the pure minority perspective is wholly unconcerned with the propriety of the majority's conduct. Such a perspective is premised upon safeguarding the minority shareholder and its sole concern is the absolute protection of the minority's reasonable expectations. Any majority actions that harm those expectations—even actions justified by a legitimate business purpose—will trigger oppression liability.⁸³

The decision of *In re Topper* reflects a pure minority perspective.⁸⁴ Myron Topper was a minority shareholder, employee, and officer of two close corporations.⁸⁵ The controlling shareholders "discharged [Topper] as an employee, terminated his salary, [and] . . . removed him as an officer."⁸⁶ Topper subsequently sought judicial dissolution of the two corporations by arguing that his discharge as an employee and his removal as an officer constituted "oppressive actions" under the applicable New York statute.⁸⁷ In response, the controlling shareholders attempted to raise a legitimate business purpose defense by arguing that "they discharged Topper with justification and, thus, their

81. *Id.* at 1089 (emphasis omitted) (quoting *Gay v. Gay's Super Markets, Inc.*, 343 A.2d 577, 580 (Me. 1975)).

82. *Cf. Nelson v. Martin*, 958 S.W.2d 643, 650 (Tenn. 1997) (upholding the termination of a close corporation shareholder because there was "no evidence that the termination of . . . employment or [the] discharge as an officer and a director were prejudicial to the corporation's best interest").

83. *See, e.g., In re Topper*, 433 N.Y.S.2d 359, 362 (Sup. Ct. 1980); *Balvik v. Sylvester*, 411 N.W.2d 383, 388 (N.D. 1987).

84. *Topper*, 433 N.Y.S.2d 359.

85. *See id.* at 361. Topper owned 33% of each corporation's stock. *See id.*

86. *Id.* at 362.

87. At the time of the *Topper* decision, § 1104-a(a) of the New York Business Corporation Law stated in part that the "holders of twenty percent or more of all outstanding shares" of a close corporation could sue for dissolution on the grounds that "[t]he directors or those in control of the corporation have been guilty of illegal, fraudulent or oppressive actions toward the complaining shareholders." *See id.* at 362-63 (quoting N.Y. BUS. CORP. LAW §§ 1104-a(a), 1104-a(a)(1) (McKinney 1979) (amended 1998)).

conduct escapes statutory sanction."⁸⁸ The *Topper* court, however, squarely rejected this majority-centered argument in favor of a pure minority perspective:

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 corporations that the respondents' actions have severely damaged petitioners reasonable expectations and constitute a freeze-out of petitioner's interest; consequently, they are deemed to be "oppressive" within the statutory framework.⁸⁹

As this passage indicates, the *Topper* court gave no consideration to the propriety or justifiability of the majority's conduct. Instead, the court focused its oppression analysis solely on the damage to the petitioner's reasonable expectations.

The literal language of *Topper* as well as *Balvik* suggests that if the reasonable expectations of the minority shareholder are frustrated, any justification for the majority's conduct is "irrelevant."⁹⁰ If this language is accepted at face value, oppression liability would arise even if the minority shareholder was terminated for his own misconduct or incompetence.⁹¹ When such improper conduct is present, how-

88. *Id.* at 361. The opinion does not specify the precise nature of the controlling shareholders' alleged business justification.

89. *Id.* at 362 (emphasis added).

90. *Id.* at 362; see *Balvik v. Sylvester*, 411 N.W.2d 383, 388 (N.D. 1987) ("little relevance"); *supra* text accompanying notes 7-10, 84-89 (discussing *Balvik* and *Topper*); see also *Gunzberg v. Art-Lloyd Metal Prods. Corp.*, 492 N.Y.S.2d 83, 86 (App. Div. 1985) (affirming a finding of oppression and noting that "[e]ven if there were sound business reasons for the corporation's actions, it is clear that the ultimate beneficiary was [the controlling shareholder], not petitioners [the minority shareholders]"); Hillman, *supra* note 27, at 46 n.141 ("Many would argue that the denial of employment is a classic example of oppression regardless of whether those in control have good reasons for their action." (emphasis added)); D. Prentice, *Protection of Minority Shareholders*, 1972 CURRENT LEGAL PROBS. 124, 145 (1972) ("It is irrelevant whether or not the majority are acting bona fide, what matters is the consequence of the majority's act and not the motive underlying it.").

91. Even the decision of *In re Kemp & Beatley, Inc.*, 473 N.E.2d 1173 (N.Y. 1984), arguably supports this proposition. As the *Kemp* court observed:

The purpose of this involuntary dissolution statute is to provide protection to the minority shareholder whose reasonable expectations in undertaking the venture have been frustrated and who has no adequate means of recovering his or her investment. It would be contrary to this remedial purpose to permit its use by minority shareholders as merely a coercive tool. *Therefore, the minority shareholder whose own acts, made in bad faith and undertaken with a view toward forcing an involuntary dissolution, give rise to the complained-of oppression should be given no quarter in the statutory protection.*

Id. at 1180 (emphasis added) (citation omitted). This passage suggests that even minority misconduct or incompetence is not a bar to oppression relief so long as the minority's actions were not intended to force an involuntary dissolution. Literally read, the termination of a minority shareholder for stealing from the business may be oppressive if the theft was motivated by greed rather than by a desire to dissolve the company. See, e.g., *In re O'Neill*, 626 N.Y.S.2d 813, 814 (App. Div. 1995) (noting that "[a minority shareholder's] illegal acts do not bar him from seeking relief, inasmuch as there is no indication that the acts were undertaken with the intent

ever, it seems odd that pure minority courts would characterize the minority's expectation of continued employment or management participation as a "reasonable" expectation. Nevertheless, such a characterization makes sense given that pure minority courts appear to define "reasonable" expectations in an expansive manner. So long as there is evidence that all of the investors shared a basic understanding of employment or participation at the *inception* of the venture, pure minority courts seem to protect that understanding as a reasonable expectation⁹² regardless of the circumstances that arise *after* the business commences (e.g., subsequent misconduct or incompetence by the minority shareholder).⁹³

of forcing an involuntary dissolution of the corporation" (emphasis added); *In re Burack*, 524 N.Y.S.2d 457, 460 (App. Div. 1988) (responding to an assertion that a minority shareholder's termination "was provoked by his own bad acts" by noting the following: "[T]he doctrine of 'unclean hands' is not an automatic bar to relief . . . Only when a minority shareholder whose own acts, made in bad faith and undertaken with a view toward forcing an involuntary dissolution, give rise to the complaint of oppression should relief be barred. On the record before us, we cannot conclude that [the terminated shareholder's] actions were undertaken with this specific view in mind." (citations omitted)).

92. Indeed, courts have noted that a reasonable expectation is one that is understood by all of the shareholders at the inception of the venture. See *infra* note 245 and accompanying text.

93. For example, the *Topper* court's language suggests that it was satisfied that Topper's expectation of active participation in the business was understood by all of the shareholders at the inception of the venture. See, e.g., *Topper*, 433 N.Y.S.2d at 361 ("The petitions and the supporting affidavits in this case show conclusively, and respondents do not deny, that petitioner Topper associated himself with [the controlling shareholders] . . . in the expectation of being an active participant in the operation of both corporations." (emphasis added)); *id.* at 362 ("The Court finds that the undisputed understanding of the parties was such at the time of the formation of the corporations that the respondents' actions have severely damaged petitioner's reasonable expectations . . ."). Once this mutual understanding was proven, the court considered Topper's expectation of active participation to be "reasonable" and enforceable regardless of any subsequent circumstances that may have justified the controlling shareholders' actions.

There is, however, another possible interpretation. Perhaps the *Topper* and *Balvik* courts simply concluded that the majority's justification for its actions was pretextual, or perhaps they believed that the minority shareholder had acted "badly," but not badly enough to deem the expectation of continued employment and management participation "unreasonable." This interpretation, of course, suggests that the *Topper* and *Balvik* courts did consider the majority's justification as part of their reasonable expectations inquiry. If true, two implications arise. First, the "irrelevance" language should be limited to the particular facts of those cases rather than understood as a broader proposition. See Hillman, *supra* note 27, at 51 n.161 (suggesting that *Topper* may be "insignificant as a matter of precedent"). Second, *Topper* and *Balvik* should not be viewed as reflecting a pure minority perspective. Instead, it may be more appropriate to view the pure minority perspective as an analytical construct rather than as an actual position in the case law. It should be noted, however, that both courts suggest in no uncertain terms that the majority's justification—whether credible or not—is irrelevant to the oppression analysis. See *supra* notes 90-91 and accompanying text. Asserting that *Topper* and *Balvik* represent a pure minority perspective, therefore, seems both plausible and fair.

C. Analyzing Shareholder Oppression from Pure Perspectives

The stark contrast between the pure majority and pure minority perspectives produces different outcomes in a number of factual scenarios. Indeed, because the pure formulations take diametrical positions on the relevance of the majority's justification, different results are reached whenever the majority shareholder has a legitimate business purpose for her actions. For example, when minority fault⁹⁴ is present, the pure majority perspective is unlikely to find oppression liability. As the *Priebe* decision indicates, when the minority shareholder's misconduct or incompetence is harming the corporation, efforts to eliminate that harm (e.g., terminating the minority shareholder's employment) are surely serving a legitimate business purpose.⁹⁵ From a pure minority perspective of oppression, however, the fact that the minority shareholder's fault brings about the allegedly oppressive act is unimportant. As *Topper* and *Balvik* illustrate,⁹⁶ the focus of a pure minority perspective is the absolute protection of the minority's interests. The minority's fault and the majority's corresponding justification for its actions are simply irrelevant to the oppression analysis.⁹⁷ Thus, in this "minority fault" context, the choice of perspective will make an outcome-determinative difference.

94. See *supra* note 32 (defining "minority fault").

95. See *supra* text accompanying notes 2-6 (discussing *Priebe*); see, e.g., *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657, 664 (Mass. 1976) (granting oppression-based relief to a minority shareholder who was discharged from employment and removed from the board of directors, and noting that "[t]here was no showing of misconduct on Wilkes's part as a director, officer or employee of the corporation which would lead us to approve the majority action as a legitimate response to the disruptive nature of an undesirable individual bent on injuring or destroying the corporation"); see also *Connolly v. Bain*, 484 N.W.2d 207, 210-11 (Iowa Ct. App. 1992) (concluding that a minority shareholder's lack of salaried employment in a close corporation did not constitute a breach of fiduciary duty, in part because the minority's "conduct and demeanor justified [the controlling group] not to employ [him] . . . [The minority shareholder] was a recalcitrant shareholder who repeatedly threatened to develop the product on his own. He devoted less time developing the product than [the controlling group]"); *Harris v. Mardan Bus. Sys., Inc.*, 421 N.W.2d 350, 353 (Minn. Ct. App. 1988) (concluding that the discharge of a minority shareholder for performance deficiencies was justified by a legitimate business purpose and was not oppressive); *Baker v. Commercial Body Builders, Inc.*, 507 P.2d 387, 390, 396 (Or. 1973) (noting that the majority shareholder discharged the minority shareholder from employment purportedly because the minority shareholder "had made no sales" and "was not doing the company any good," and suggesting that the termination was not oppressive because the minority shareholder "apparently contributed little, if anything, to [the company's] successful operation"); *Thompson*, *supra* note 37, at 220 ("The decisions reflect a lessening of judicial willingness to provide relief as the minority shareholder's conduct becomes more objectionable.").

96. See *supra* text accompanying notes 84-89 (discussing *Topper*); *supra* text accompanying notes 7-10 (discussing *Balvik*).

97. See, e.g., *Topper*, 433 N.Y.S.2d at 362; *Balvik v. Sylvester*, 411 N.W.2d 383, 388 (N.D. 1987).

The majority shareholder may also have a legitimate business justification for her actions that is unrelated to the minority's fault. For example, poor business or economic conditions, the advent of new technology, or the elimination of a line of business may all constitute a legitimate business reason that, from a pure majority perspective, justifies the termination of a minority shareholder's employment.⁹⁸ From a pure minority perspective, of course, the justifications are irrelevant. If the termination has frustrated the minority's reasonable expectation of continued employment, oppression liability will arise. As a consequence, when both majority fault⁹⁹ and minority fault¹⁰⁰ are absent, a court's choice between pure majority and pure minority perspectives will often determine whether relief is granted.¹⁰¹

Despite the implication of the "not contradictory" and "little difference" characterizations,¹⁰² therefore, majority and minority perspectives are far from similar when their pure formulations are considered. Given the extremity of difference between the pure majority and the pure minority perspectives, the choice between the two positions will very often have an outcome-determinative impact. The

98. See Sandra K. Miller, *Should the Definition of Oppressive Conduct by Majority Shareholders Exclude a Consideration of Ethical Conduct and Business Purpose*, 97 DICK. L. REV. 227, 254 (1993) (discussing a minority shareholder's termination resulting from the discontinuance of a line of business); see also *infra* note 154.

99. See *supra* note 31 (defining "majority fault").

100. See *supra* note 32 (defining "minority fault").

101. Some statutory schemes support the proposition that pure perspectives will reach different outcomes in a "no fault" scenario. Statutory provisions in California and North Carolina, for example, have been referred to as "no-fault" dissolution statutes because they are structured to provide relief to the minority shareholder even if the majority's conduct is blameless. See, e.g., Thompson, *supra* note 37, at 210 (citing California and North Carolina as "states [that] explicitly contain 'no fault' grounds for dissolution in their statutes"). See generally Hillman, *supra* note 27, at 55-60 (describing the California and North Carolina statutes). Indeed, both statutes allow dissolution or other remedies whenever "reasonably necessary for the protection of the rights or interests of the complaining shareholder." CAL. CORP. CODE § 1800(b)(5) (West 1995); accord N.C. GEN. STAT. § 55-14-30(2) (1999); see Hillman, *supra* note 27, at 56 & n.185. Based on this language, commentators have noted that "[t]he question of motivation or fault has no role under the rights or interests inquiry," and that "this feature . . . makes the California and North Carolina statutes promising sources of relief for dissatisfied minority shareholders." *Id.* at 59-60; see also Edwin J. Bradley, *An Analysis of the Model Close Corporation Act and a Proposed Legislative Strategy*, 10 J. CORP. L. 817, 823 n.31 (1985) (noting that "[t]he focus [of the North Carolina statute] is to be on fairness to the plaintiff and not on the defendant's behavior"); Hillman, *supra* note 27, at 56-57 ("[T]he fact that the ground for relief has not been stated with reference to the misconduct of the controlling shareholders removes significant obstacles . . ."). Because the statutes are "tilted" to providing relief to minority shareholders even when majority fault is absent, these provisions reflect a minority approach and exemplify the distinction between the perspectives. It should be noted, however, that the North Carolina courts have refused to grant relief under their statute unless there is proof that the frustrated expectation "was without fault of plaintiff and was in large part beyond his control." *Meiselman v. Meiselman*, 307 S.E.2d 551, 564 (N.C. 1983).

102. See *supra* text accompanying notes 14-19.

"modified" formulations of the perspectives, however, represent middle ground approaches that are more similar in operation. Seeing the differences between the formulations, therefore, is more difficult. As a consequence, the modified perspectives will be examined in greater detail and with a greater analysis of the potential factual scenarios.

IV. DISTINCTIONS BETWEEN THE "MODIFIED" PERSPECTIVES OF SHAREHOLDER OPPRESSION

Some courts have been troubled by the practical implications of adopting "pure" perspectives. For example, even courts that favor a minority-centered perspective are often uncomfortable granting relief when the minority shareholder's own misconduct or incompetence has brought about the allegedly oppressive act. In these circumstances, even minority-perspective courts favor the majority's discretion to take action. Similarly, some majority-centered courts are reluctant to ignore minority interests in their oppression analyses. These majority-centered courts recognize, at least to some extent, that the minority's position in the close corporation is precarious and is deserving of consideration. Thus, some courts have suggested middle ground, or "modified," majority and minority perspectives of oppression that are less absolute than their respective "pure" formulations.

A. The Modified Majority Perspective

The modified majority perspective of oppression still concerns itself with the propriety of the majority's conduct and the existence of a legitimate business purpose. Unlike the pure majority perspective, however, the modified majority perspective also incorporates minority interests into its oppression analysis. For example, in *Wilkes v. Springside Nursing Home, Inc.*, the court echoed a pure majority perspective of oppression by explaining that the majority could defend against an oppression lawsuit by "demonstrat[ing] a legitimate business purpose for its action."¹⁰³ Significantly, however, the court went on to state the following:

When an asserted business purpose for their action is advanced by the majority, however, we think it is open to minority stockholders to demonstrate that the same legitimate objective could have been achieved through an alternative course of action less harmful to the minority's interest. If called on to settle a dispute, our courts must

103. *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657, 663 (Mass. 1976).

weigh the legitimate business purpose, if any, against the practicability of a less harmful alternative.¹⁰⁴

Despite the apparent significance of this “less harmful alternative” language, there has been little discussion of it by courts and commentators.¹⁰⁵ Undeniably, however, the inclusion of this language injects a consideration of minority interests into the majority perspective’s oppression inquiry. As the modified majority perspective begins to incorporate minority concerns, of course, the gap between the perspectives begins to narrow.

As mentioned, however, a minority perspective is concerned *primarily* with the minority’s interests.¹⁰⁶ It is unclear whether the courts will extend the “less harmful alternative” language that far. Indeed, although the less harmful alternative language incorporates minority interests into the majority perspective’s oppression inquiry, those interests may still be secondary to concerns about corporate welfare. As long as the modified majority perspective remains primarily concerned with the corporation’s interests, such an inquiry will remain distinguishable from the minority perspective.

Put differently, the extent to which the modified majority approach narrows the gap between the majority and minority perspectives depends upon what the courts will consider a less harmful alternative. If *any* alternative course of action less harmful to the minority’s interests qualifies, regardless of whether the alternative is equally feasible and cost-effective to the corporation, then it is fair to assert that safeguarding minority shareholders is the primary concern of the modified majority perspective. On the other hand, if a less harmful alternative to the majority’s conduct must be equally feasible and cost-effective to the corporation,¹⁰⁷ then protecting the majority’s

104. *Id.* (emphasis added) (citations omitted); accord *Solomon v. Atlantis Dev., Inc.*, 516 A.2d 132, 136 (Vt. 1986); see, e.g., *Daniels v. Thomas, Dean & Hoskins, Inc.*, 804 P.2d 359, 366 (Mont. 1990) (“[T]he controlling group should not be stymied by a minority stockholder’s grievances if the controlling group can demonstrate a legitimate business purpose and the minority stockholder cannot demonstrate a less harmful alternative.” (emphasis added)).

105. Even the *Wilkes* court provided no discussion or analysis of its “less harmful alternative” restriction. See *Wilkes*, 353 N.E.2d at 663-64; see also *Peeples*, *supra* note 69, at 500 (“The *Wilkes* court, however, did not have to demonstrate the operation of the less harmful means approach. Instead, the court simply acknowledged, without elaboration, that comparisons will be necessary.”).

106. See *supra* text accompanying note 72.

107. Cf. *Davey v. City of Omaha*, 107 F.3d 587, 593 (8th Cir. 1997) (noting, in a Title VII disparate impact analysis, that “[e]ven if the employer can demonstrate a valid business justification, the plaintiff still has the opportunity to persuade the fact finder that alternative practices would have equally satisfied the employer’s interests without creating a disparate impact,” and stating that “[i]n determining whether proffered alternatives are equally effective, the fact finder may consider factors such as efficiency, cost, or other burdens associated with the alternative”).

discretion to act in the corporation's interest constitutes the focus of the modified majority perspective.

To flesh out these considerations, assume that a close corporation minority shareholder claims that the majority shareholder's refusal to declare dividends constitutes oppressive conduct.¹⁰⁸ The majority shareholder defends by asserting and proving an immediate need to retain profits for the replacement of outdated equipment. In response, the minority shareholder demonstrates that the corporation can borrow funds to satisfy its equipment replacement objective. The minority asserts that borrowing money for the replacement is an alternative course of action less harmful to its interests, as the retained profits can then be used for the payment of dividends. Assume, however, that borrowing money for the equipment replacement is more expensive for the company than using retained earnings.¹⁰⁹

Replacing outdated equipment typically serves the corporation's interests. As a consequence, the need for replacement is likely to suffice as a legitimate business purpose for the refusal to declare dividends.¹¹⁰ From a minority perspective, however, the lack of dividend payments may very well violate the minority's reasonable expectations depending on the understandings of the parties and the amount of time since dividends were last paid.¹¹¹ Absent considerations of a less harmful alternative, therefore, majority and minority perspectives could reach different liability outcomes on these facts.

But what of the minority's proposed alternative of borrowing the needed funds? Such a suggestion appears to constitute a *Wilkes*-like less harmful alternative given that it accomplishes the business objective of funding equipment replacement while inflicting less harm upon the minority shareholder (i.e., retained earnings are freed up for dividends). Compared to the majority's proposed action, however, the minority's borrowing alternative is more expensive for the corporation (i.e., borrowing is costlier than using retained funds). The less harmful

108. See *supra* text accompanying note 43 (noting that the refusal to declare dividends is a common freeze-out technique).

109. Professor Peeples sets forth a near-identical hypothetical in commenting on the *Wilkes* framework. See Peeples, *supra* note 69, at 500.

110. See *supra* note 64 and accompanying text (noting that a legitimate business purpose is typically linked to a legitimate corporate purpose).

111. See, e.g., *Exadaktilos v. Cinnaminson Realty Co.*, 400 A.2d 554, 562 (N.J. Super. Ct. Law Div. 1979), *aff'd*, 414 A.2d 994 (N.J. Super. Ct. App. Div. 1980); *Gimpel v. Bolstein*, 477 N.Y.S.2d 1014, 1020-22 (Sup. Ct. 1984); see also *Moll*, *supra* note 29, at 553 (stating that every close corporation shareholder has a "general" reasonable expectation "that her commitment of capital entitles her to a proportionate share of the corporate earnings"); cf. *Patton v. Nicholas*, 279 S.W.2d 848, 854 (Tex. 1955) (noting that "the malicious suppression of dividends is a wrong akin to breach of trust . . . for which the courts will afford a remedy").

alternative language does not necessarily indicate, however, that economic equivalence to the corporation has any relevance to the analysis.¹¹² Literally construed, the alternative course of action must only (1) accomplish the business objective, and (2) harm the minority less than the majority's actions.¹¹³ The effect on the corporation is arguably irrelevant so long as the majority's business objective is accomplished.¹¹⁴ Conversely, of course, the fact that the minority's proposal creates a greater corporate expense than the majority's conduct may convince a court to reject the alternative.¹¹⁵ Because courts have yet to flesh out these issues, these possibilities are all plausible outcomes.

In short, if economic or other equivalence to the corporation is not a prerequisite of a less harmful alternative, the modified majority perspective shifts the primary focus of the legitimate business purpose inquiry to protection of the minority's interests. In so doing, of course, the oppression analysis of the modified majority perspective functions similarly, if not identically, to the oppression analysis of the minority perspective. If equivalence to the corporation is required, however, corporate benefit continues as the emphasis of the modified majority perspective, and the gap between majority and minority perspectives remains.¹¹⁶

B. The Modified Minority Perspective

The modified minority perspective of oppression still focuses on protecting the minority shareholder's reasonable expectations. In contrast to the pure minority perspective, however, the modified minority perspective is more contextualized, as it only protects expectations that are reasonable in the particular circumstances before the court. As a consequence, and again in contrast to its pure formulation,

112. See Mitchell, *supra* note 71, at 1709 (noting that the *Wilkes* less harmful alternative restriction "could exact a price in efficiency by requiring controlling interests to structure transactions in a more expensive manner to avoid harm to the minority"); Peeples, *supra* note 69, at 507 ("Questions remain, however, about the guidelines for the court's balancing of the interests of the shareholder and the corporation. The balance requires a tradeoff between economic benefit to the corporation and protection of minority interests." (footnote omitted)).

113. See *supra* text accompanying note 104.

114. See *supra* note 112; cf. Mitchell, *supra* note 71, at 1712 n.152 ("The absence of less harmful corporate means to achieve the goal of terminating *Wilkes* does not mitigate the harm to him as a shareholder.").

115. Cf. 1 O'NEAL, *OPPRESSION*, *supra* note 14, § 3:05, at 28 ("Conceivably, a court might order payment of a dividend in spite of a need for more capital and thus compel management to raise funds from other sources; but this would, indeed, be unlikely.").

116. This construction of the less harmful alternative language is more likely. See *infra* text accompanying notes 234-41.

the modified minority perspective is willing to consider the propriety and justifiability of the majority's conduct to the extent that the majority's proffered justification sheds light on whether the minority's expectation was reasonable in the circumstances at issue.¹¹⁷ For example, if the majority shareholder proves that the minority shareholder was discharged for misconduct, that justification has great relevance to the reasonableness of the minority's expectation of continued employment. Can a shareholder, in other words, have a "reasonable" expectation of continued employment when his conduct is improper? As mentioned, from a pure minority perspective, the answer appears to be yes. Indeed, if pure minority courts mean what they say, reasonable expectations are defined expansively to refer to basic understandings shared by the investors at the venture's inception.¹¹⁸ Subsequent circumstances arising after the commencement of the business, such as minority shareholder misconduct, are purportedly not considered by pure minority courts.¹¹⁹

From a modified minority perspective, however, the answer is likely no, as a court will consider the subsequent circumstances that arise (e.g., misconduct) before deeming an expectation "reasonable." A modified minority court, in other words, goes one step further in its analysis than a pure minority court. A protected "reasonable expectation" does not arise until (1) the court is satisfied that all of the investors shared a basic understanding (e.g., employment, management participation) at the venture's inception, *and* (2) the court is satisfied that all of the investors intended that basic understanding to persist in the post-inception circumstances that arise.¹²⁰ Whereas a pure minority court recognizes an enforceable "reasonable expectation" after the first step of the analysis,¹²¹ a modified minority court recognizes an

117. See, e.g., *Meiselman v. Meiselman*, 307 S.E.2d 551, 572 (N.C. 1983) (Martin, J., concurring) ("The reasons *why* the complaining shareholder's interests require protection is highly relevant in the resolution of the case.").

118. See *supra* notes 92-93 and accompanying text.

119. See *supra* notes 90-91 and accompanying text.

120. See Hillman, *supra* note 27, at 54 (noting that *Topper*, a pure minority court, differs from *Exadaktilos*, a modified minority court, "only in its analysis of the reasonableness of the expectations," and making the following observation: "In *Topper*, the court assumed that it was reasonable to have an absolute expectation of continued employment, while in *Exadaktilos* the court assumed that it was reasonable to expect continued employment only so long as the services were performed in a competent fashion and contributions were being made to the enterprise."); see also *supra* text accompanying notes 84-89 (discussing *Topper*); *infra* text accompanying notes 137-39 (discussing *Exadaktilos*).

121. See *supra* text accompanying notes 92-93.

enforceable "reasonable expectation" only after both steps have been accomplished.¹²²

The difficulty of the modified minority perspective is the second step—i.e., determining whether a basic understanding of employment or management participation at the venture's inception was intended to persist in the circumstances pending before the court. At the first step in the analysis, there is often circumstantial evidence proving the existence of a basic understanding—an understanding shared by all of the participants at the outset of the business—that investment in the company entitled a shareholder to employment and to a management role in the venture.¹²³ At the second step, however, there is generally no evidence indicating whether this basic understanding was intended to continue in particular circumstances that may subsequently arise (e.g., employee misconduct, deteriorating business conditions). Nevertheless, if modified minority courts construe this second step too narrowly—thereby construing "reasonable expectations" too narrowly—minority shareholder protections are substantially eroded. For example, if a basic understanding continues in the circumstances only where the majority lacks a legitimate business purpose for its actions, then a modified minority court effectively recognizes a "reasonable expectation" only where a legitimate business purpose is absent. Under such a construction, there is no difference between the majority and minority perspectives of oppression. As of yet, however, modified minority courts have not construed the second step in such a narrow fashion. Indeed, courts have refused to protect the minority's interests only where minority shareholder misconduct or incompetence is present.¹²⁴ To this extent, of course, modified minority courts have considered the propriety and justifiability of the majority's conduct. Just as the modified majority perspective incorporates minority concerns into its oppression analysis, so too does the modified minority perspective factor majority prerogatives, at least to some extent, into its oppression inquiry.

122. See *infra* Part V.E. (discussing the proper operation of the modified minority perspective).

123. See *infra* note 250 and accompanying text.

124. See, e.g., *Exadaktilos v. Cinnaminson Realty Co.*, 400 A.2d 554, 562 (N.J. Super. Ct. Law Div. 1979), *aff'd*, 414 A.2d 994 (N.J. Super. Ct. App. Div. 1980); *Gimpel v. Bolstein*, 477 N.Y.S.2d 1014, 1020 (Sup. Ct. 1984); see also *infra* notes 137-39, 141 and accompanying text (discussing *Exadaktilos* and *Gimpel*).

C. Analyzing Shareholder Oppression from Modified Perspectives

1. Majority Fault Present/Minority Fault Absent

The basic freeze-out scenario provides a nice launching point for considering the differences between the modified majority and modified minority perspectives. When the majority has no legitimate business purpose for its actions (i.e., majority fault is present), and when the allegedly oppressive behavior is brought about through no misconduct or incompetence of the minority (i.e., minority fault is absent), it is likely that a conventional freeze-out is at issue. In this context, there is no substantive distinction between the modified perspectives, as both approaches would conclude that oppression liability has arisen. For example, if a minority shareholder was unjustifiably discharged from employment, removed from management, and cut off from dividends, a modified majority court (as well as a pure majority court) would find liability due to the majority's lack of a legitimate business purpose for its actions.¹²⁵ The less harmful alternative inquiry would not even be reached.¹²⁶ Similarly, in the absence of minority misconduct or incompetence, a modified minority court would likely find that the minority's expectations of a job, a management position, and a proportionate share of the corporate earnings are all "reasonable" in the circumstances and are deserving of protection.¹²⁷ Thus, in the conventional freeze-out context involving only majority fault, the choice between modified perspectives makes no substantive difference.¹²⁸ In this setting, therefore, it is accurate to describe the

125. See, e.g., *Sugarman v. Sugarman*, 797 F.2d 3, 7-8 (1st Cir. 1986); *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657, 663-64 (Mass. 1976); *Hallahan v. Haltom Corp.*, 385 N.E.2d 1033, 1034 (Mass. App. Ct. 1979). As the *Wilkes* court noted:

[I]t is apparent that the majority stockholders . . . have not shown a legitimate business purpose for severing Wilkes from the payroll of the corporation or for refusing to reelect him as a salaried officer and director. . . . There was no showing of misconduct on Wilkes's part as a director, officer or employee of the corporation which would lead us to approve the majority action as a legitimate response to the disruptive nature of an undesirable individual bent on injuring or destroying the corporation. . . . It is an inescapable conclusion from all the evidence that the action of the majority stockholders here was a designed "freeze out" for which no legitimate business purpose has been suggested.

Wilkes, 353 N.E.2d at 663-64.

126. See, e.g., *Wilkes*, 353 N.E.2d at 663-65.

127. See, e.g., *In re Burack*, 524 N.Y.S.2d 457, 459-60 (App. Div. 1988); *In re Wiedy's Furniture Clearance Ctr. Co.*, 487 N.Y.S.2d 901, 903-04 (App. Div. 1985); *In re Taines*, 444 N.Y.S.2d 540, 543-44 (Sup. Ct. 1981).

A pure minority court would reach the same result, although the absence of minority misconduct or incompetence would not be a relevant factor in the court's analysis. See *supra* text accompanying notes 90-91.

perspectives as “not contradictory” and having “little difference” in practice.

2. Majority Fault Absent/Minority Fault Present

When the pure perspectives were applied to this “minority fault” scenario, different results were reached.¹²⁹ Under modified perspectives of oppression, however, this difference in result is not likely to persist. Nevertheless, because of the uncertainty surrounding the less harmful alternative restriction, there is some possibility of a continuing distinction.

From a modified majority perspective, the presence of minority fault continues to be a critical factor in the oppression analysis, as such fault provides a legitimate business justification for the majority’s actions.¹³⁰ A modified majority court, however, would also consider the minority’s interests as part of its less harmful alternative inquiry. Thus, the interpretive problems of the “less harmful alternative” language return. For example, assume that a close corporation minority shareholder lacks the skills necessary for his employment position.¹³¹ The majority discharges the shareholder for incompetence and asserts this “minority fault” as a legitimate business justification for the discharge.¹³² Rather than outright termination, however, the minority shareholder proposes that his interests would suffer less harm if the company paid for the training needed to make the minority competent in his position.¹³³ Such a proposal accomplishes the majority’s legitimate objective of having a competent and productive workforce, and it allows the minority to retain his employment. To be sure, however, training the shareholder is costly to the corporation. Moreover, operating the business on a short-handed basis during the

128. Even if the majority’s actions do not result in a complete freeze-out, unjustified majority conduct will likely trigger oppression liability under both modified majority and modified minority perspectives. For example, if the majority terminated the minority without a legitimate business purpose, but still provided adequate dividends, the perspectives would likely reach the same result. A modified majority court would find oppression liability due to the unjustified termination, and a modified minority court would find oppression liability due to the likely frustration of the minority’s reasonable expectation of employment.

129. See *supra* notes 94-97 and accompanying text.

130. See, e.g., *Harris v. Mardan Bus. Sys., Inc.*, 421 N.W.2d 350, 353 (Minn. Ct. App. 1988); *Priebe v. O’Malley*, 623 N.E.2d 573, 576 (Ohio Ct. App. 1993); see also *supra* note 95 and accompanying text.

131. Assume further that the shareholder possessed no additional skills that could be profitably used by the corporation.

132. See *supra* notes 95, 130 and accompanying text.

133. In an attempt to make the alternative more palatable, assume that the minority shareholder additionally proposes a reduction or suspension of his salary during the training period.

training period may be less feasible than hiring an immediate replacement. If the less harmful alternative analysis ignores the effects on the corporation, however, terminating the incompetent minority shareholder may give rise to oppression liability. Although such an outcome seems bizarre, it stems directly from the possibility that a less harmful alternative inquiry will not require economic or other equivalence to the corporation.¹³⁴ Thus, although it is likely that a modified majority court would reject oppression liability in situations of minority fault, the puzzle of the less harmful alternative suggests at least the possibility that liability will be found.

From a modified minority perspective, the presence of minority misconduct or incompetence is also an important component of the oppression analysis. As mentioned, a modified minority court looks to the majority's proffered justification as part of its assessment of the "reasonableness" of the expectation in the circumstances at issue.¹³⁵ When the minority shareholder is guilty of misconduct or incompetence, modified minority courts have effectively held that expectations of continued employment and management participation are unreasonable and unworthy of protection.¹³⁶ For example, in *Exadaktilos v. Cinnaminson Realty Co.*, a minority shareholder brought an oppression claim after being terminated from his close corporation position.¹³⁷ The court stated that the plaintiff's discharge "was because of his unsatisfactory performance," as the evidence demonstrated "that plaintiff failed to get along with employees, causing the loss of key personnel, that he quit on more than one occasion, without reason or notice, and that he was not compatible with the other principals."¹³⁸ As the *Exadaktilos* court concluded:

The circumstances under which the parties' expectations in these areas were disappointed do not establish oppressive action toward plaintiff by the controlling shareholders. The promise of employment was honored, the opportunity being lost to plaintiff through no fault of defendants. The parties' expectation that plaintiff would at some time participate in management was likewise thwarted by plaintiff's failure to satisfy the condition precedent to participation, [i].e., that he learn the business.¹³⁹

As *Exadaktilos* indicates, the minority shareholder's expectation of continued employment was unreasonable from a modified minority

134. See *supra* text accompanying notes 112-14.

135. See *supra* text accompanying note 117.

136. See, e.g., *Exadaktilos v. Cinnaminson Realty Co.*, 400 A.2d 554, 562 (N.J. Super. Ct. Law Div. 1979), *aff'd*, 414 A.2d 994 (N.J. Super. Ct. App. Div. 1980); *Gimpel v. Bolstoin*, 477 N.Y.S.2d 1014, 1020 (Sup. Ct. 1984).

137. See *Exadaktilos*, 400 A.2d at 556, 561-62.

138. *Id.* at 561.

139. *Id.* at 561-62.

perspective because of his “blameworthy” conduct.¹⁴⁰ *Exadaktilos* suggests, therefore, that the distinctions between the modified perspectives are likely more form than substance when only minority fault is involved.¹⁴¹ Because of interpretive questions surrounding the less harmful alternative language,¹⁴² however, the perspectives may very well reach different results in this scenario.

3. Majority Fault Present/Minority Fault Present

Interesting issues are raised when the modified perspectives of oppression are applied to a factual situation involving both majority and minority fault. Assume, for example, that a majority shareholder

140. See Hillman, *supra* note 27, at 54 (“Arguably, *Exadaktilos* differs from *Topper* only in its analysis of the reasonableness of the expectations.”); *id.* at 53 (“The point of distinction between *Topper* and *Exadaktilos* is that the court in the latter case also considered the propriety of the actions by the controlling shareholders”); see also *supra* note 120.

141. The decision of *Gimpel v. Bolstein*, 477 N.Y.S.2d 1014 (Sup. Ct. 1984), further illustrates the likely lack of substantive distinction between the modified perspectives when only minority fault is involved. In *Gimpel*, Robert Gimpel was a minority shareholder who stole from the business and was eventually discharged from employment. See *id.* at 1017. Claiming that the majority had engaged in oppressive conduct towards him, Gimpel filed a petition to dissolve the corporation. See *id.* at 1017-18. In assessing whether the majority’s conduct could be considered oppressive, the *Gimpel* court noted the “burdensome, harsh, and wrongful conduct” definition—an approach that reflects a majority perspective—as well as the “reasonable expectations” definition—an approach that reflects a minority perspective. See *id.* at 1018-19; *supra* text accompanying notes 62, 69. Significantly, the court observed that Gimpel’s exclusion from active corporate participation did not merit relief under either definition of oppression. Under the “wrongful conduct” definition, the court stated the following:

[Gimpel’s] discharge, as well as his subsequent exclusion from corporate management, were not oppressive. It was clearly not wrongful for the corporate victim of a theft to exclude the thief from the councils of power. The salient point here . . . is that the petitioner himself was the initial wrongdoer. Thus, the only forms of participation which may fairly be said to be open to [Gimpel] are those open to a shareholder in the position of a stranger: possible entitlement to dividends, voting at shareholders’ meetings, and access to corporate records.

Id. at 1020 (footnote omitted). Moreover, from a reasonable expectations standpoint, the court came to the same conclusion:

[I]t must be recognized that “reasonable expectations” do not run only one way. To the extent that [Gimpel] may have entertained “reasonable expectations” of profit . . . the other shareholders also entertained “reasonable expectations” of fidelity and honesty from him. All such expectations were shattered when [Gimpel] stole from the corporation. His own act broke all bargains. Since then, the only expectations he could reasonably entertain were those of a discovered thief: ostracism and prosecution. . . . [Gimpel] may not lay claim to the reasonable expectation of any specific benefits

Id. at 1019-20 (emphasis added) (citation omitted).

Although *Gimpel* does not incorporate a less harmful alternative analysis into its oppression inquiry, the court’s reasoning reflects the underlying themes of the modified perspectives. Gimpel’s exclusion was “proper” from a modified majority perspective because his continued presence was a threat to the corporation’s well-being. Similarly, Gimpel’s expectation of continued participation was unreasonable from a modified minority perspective given the circumstances of his misconduct.

142. See *supra* notes 106-15 and accompanying text.

terminates a minority shareholder's employment in part because the minority's work was inadequate and in part because the majority wanted to capture the minority's investment and exclude him from corporate returns. In other words, assume the existence of evidence indicating that the majority had a mixed motive for terminating the minority shareholder—a motive that was partially proper (termination for poor performance) and partially improper (termination for freeze-out purposes).¹⁴³

A modified majority court is unlikely to find oppression liability in this mixed motive situation. Indeed, a modified majority court (as well as a pure majority court) would likely bless conduct motivated by at least one legitimate business purpose.¹⁴⁴ Because there is evidence that the minority shareholder's termination was prompted, at least in part, by the minority's inadequate employment performance, "a" legitimate business purpose has been shown, even if there are additional reasons that motivated the termination.¹⁴⁵ It should be noted, however, that a court may cast this issue in causation terms. The majority shareholder may have to prove that even if freeze-out considerations were absent, the decision to terminate would still have been made due to the minority's incompetence.¹⁴⁶ A modified majority court would, of course, also pursue a less harmful alternative inquiry. With

143. At trial, of course, establishing a "true" mixed motive may be difficult. For example, the decision-maker may find that the majority's proof of minority fault is not credible. If the majority's proffered justification is rejected, the fact pattern becomes a relatively straightforward freeze-out scenario (i.e., majority fault present/minority fault absent). See, e.g., *O'Donnell v. Marine Repair Servs., Inc.*, 530 F. Supp. 1199, 1205-08 (S.D.N.Y. 1982); *Zimmerman v. Bogoff*, 524 N.E.2d 849, 854 (Mass. 1988). Similarly, if the decision-maker credits the majority's assertion of minority fault, any contrary evidence suggesting that the majority was motivated by improper freeze-out concerns may be downplayed or discredited. The fact pattern would then resemble a majority fault absent/minority fault present scenario. See, e.g., *Michaud v. Morris*, 603 So. 2d 886, 888-89 (Ala. 1992).

144. See James D. Cox, *Equal Treatment for Shareholders: An Essay*, 19 CARDOZO L. REV. 615, 635 (1997) (noting that "a business purpose inquiry searches for any one of many possible justifications for a transaction"); Mitchell, *supra* note 71, at 1708 n.142 (discussing the *Wilkes* approach and stating that "the proof that the fiduciary must offer is not of selfless devotion, or even fairness, but simply of a business purpose, which should generally be easy to establish").

145. Cf. *Ueltzhoffer v. Fox Fire Dev. Co.*, Nos. 9871, 9900, 1991 WL 271584, at *8 (Del. Ch. Dec. 19, 1991), *aff'd sub nom.* *Fox Fire Dev. Co. v. Hans*, 618 A.2d 90 (Del. Super. Ct. 1992) ("I am not prepared to conclude that the [controlling shareholders] terminated [the minority shareholder] for the sole and improper purpose of freezing him out of the corporate entities." (emphasis added)); *Nelson v. Martin*, 958 S.W.2d 643, 650 (Tenn. 1997) ("If [the controlling shareholders] were protecting legitimate interests of the corporation, the presence of spite or ill will would not render them or the corporation liable.").

146. See, e.g., *Mt. Healthy City Sch. Dist. Bd. v. Doyle*, 429 U.S. 274, 286-87 (1977) (discussing a "test of causation" in a mixed motive case where the defendant has to show "that it would have reached the same decision" even in the absence of an impermissible motive).

the presence of minority incompetence, however, a realistic alternative short of termination seems unlikely.¹⁴⁷

Similarly, because of the presence of minority incompetence, a modified minority court would likely find that the minority's expectation of continued employment was unreasonable in the circumstances. Put differently, it is not reasonable for the shareholder to expect that her employment status is secure when the circumstances indicate that her job performance is inadequate.¹⁴⁸ Under this reasoning, a modified minority court would not find that the termination was oppressive.

To the extent that a modified minority court considers the majority's justification in its oppression analysis, however, a court may be troubled by the presence of improper freeze-out considerations. Although it is unlikely, a court may enforce an expectation that a termination will be based solely, or at least predominately, on the presence of the minority's incompetence.¹⁴⁹ If a termination is partially or predominately motivated by illegitimate freeze-out considerations, a modified minority court may factor that into its balancing of majority and minority interests and correspondingly lean towards providing relief. Most likely, however, both modified majority and modified minority courts would refuse to characterize the termination as oppressive in this mixed motive scenario. Nevertheless, because the presence of freeze-out considerations raises judicial suspicion, there is some possibility that outcome distinctions will remain.¹⁵⁰

4. Majority Fault Absent/Minority Fault Absent

The absence of both majority and minority fault provides perhaps the purest context in which to measure whether meaningful distinctions exist between the perspectives. When the majority has a

147. As mentioned, a very pro-minority construction of the "less harmful alternative" language is theoretically possible. Such a construction might require the majority to offer rehabilitation opportunities before terminating the shareholder. See *supra* text accompanying notes 131-34.

148. See, e.g., *Exadaktilos v. Cinnaminson Realty Co.*, 400 A.2d 554, 562 (N.J. Super. Ct. Law Div. 1979), *aff'd*, 414 A.2d 994 (N.J. Super. Ct. App. Div. 1980).

149. Cf. *Leigh Furniture & Carpet Co. v. Isom*, 657 P.2d 293, 307 (Utah 1982) (noting that an interference with contract claim can be established by proof of "improper purpose," and stating that "[t]he alternative of improper purpose will be satisfied where it can be shown that the actor's predominant purpose was to injure the plaintiff" (emphasis added)). Under this limitation, the majority could evade oppression liability—even if the termination was motivated by improper freeze-out considerations—as long as the discharge was predominantly motivated by the unsatisfactory performance of the minority shareholder.

150. The court may believe, for example, that the existence of freeze-out considerations makes it more likely that the majority shareholder will couple the termination with additional freeze-out measures, such as the denial of dividends. Due to these concerns, a modified minority court may choose to grant some relief.

legitimate business purpose for its actions and the minority has not been guilty of misconduct or incompetence, the question of liability will turn on the oppression perspective utilized by the decision-maker. A simple hypothetical supports this proposition. Assume that a minority shareholder performs his employment tasks for a close corporation in a superior fashion. Due to technological advances, however, the minority shareholder's tasks can now be performed entirely by machine. Despite the superior performance of the minority shareholder, assume that it is indisputable that the machine will result in greater productivity and diminished costs. In these circumstances, would terminating the employment of the minority shareholder result in oppression liability?

From a modified majority perspective, the productivity gains and cost savings clearly benefit the corporation and suffice as a legitimate business purpose for the termination. Moreover, assuming that the machine operates at productivity levels beyond human capacities, skills training or other pro-minority less harmful alternatives are unlikely.¹⁵¹

From a modified minority perspective, however, the termination of the minority shareholder is problematic. As mentioned, a modified minority court will consider the majority's justification in its effort to protect reasonable expectations in the circumstances.¹⁵² In this context, therefore, modified minority courts must ask whether it is reasonable for a minority shareholder to expect continued employment when a technological advance can perform the shareholder's job in a more efficient and less expensive manner. Most likely, of course, the shareholders did not discuss this possibility at the time they decided to commit capital to the business. It is tempting, therefore, to fall back on a default presumption that a reasonable expectation exists only when the majority shareholder lacks a legitimate business purpose for his actions. As mentioned, however, modified minority courts have not yet gone this far. The modified minority precedents seem to deny protection to established expectations of employment only where

151. *See supra* text accompanying notes 131-34. The ultimate pro-minority less harmful alternative, of course, involves compelling the majority shareholder to retain the minority shareholder in his salaried position, even though the machine will now be performing the minority's usual job tasks. Obviously, such a measure requires the corporation to pay an unnecessary salary to an employee whose services are no longer needed. If corporate expense and practicality are irrelevant to the less harmful alternative analysis, however, such a result remains within the realm of possibility.

152. *See supra* note 117 and accompanying text.

minority shareholder misconduct or incompetence is present.¹⁵³ To the extent that the minority shareholder in this hypothetical is performing his employment tasks in a superior and loyal fashion, the minority's continued employment falls outside of the "unprotected" precedent and may very well constitute an enforceable "reasonable expectation" in the circumstances.¹⁵⁴

Some courts may also object to this hypothetical on the grounds that the majority shareholder is continuing to receive the financial and nonfinancial benefits of close corporation employment¹⁵⁵ while the minority shareholder loses these benefits as a result of the termination. Indeed, a number of courts have suggested that the majority's retention of disproportionate benefit is the hallmark of shareholder oppression.¹⁵⁶ It is useful, therefore, to explore an additional hypothetical. Assume that a two-person close corporation is earning \$200,000 in profits and is distributing it equally to the two shareholders as salary (i.e., \$100,000 each). An economic recession dampens consumer spending such that the corporation is now earning only \$100,000 in profits. To reduce corporate expenses, the majority shareholder terminates her own employment as well as the employment of the minority shareholder. One professional manager is hired to do the work of both shareholders at a \$100,000 salary. In response, the minority shareholder files a lawsuit asserting that his termination amounts to oppressive conduct.

153. See, e.g., *Exadaktilos*, 400 A.2d at 562; *Gimpel v. Bolstein*, 477 N.Y.S.2d 1014, 1020 (Sup. Ct. 1984).

154. See Hillman, *supra* note 27, at 80. As Professor Hillman observed:

The employment expectation may be defeated under circumstances in which the participant is willing and able to perform employment services but is not permitted to do so by those in control. The reasons for denying employment may range from an attempt to force the participant to sell his or her interest at a distress price, for which relief based on the misconduct of those in control may be available, to deteriorating business conditions or declining needs for particular skills. To the extent that relief is not otherwise available, denial of employment in these circumstances presents the clearest case for relief under an expectations-based analysis.

Id. (footnotes omitted).

155. See *infra* notes 192-98 and accompanying text.

156. See, e.g., *Donahue v. Rodd Electrotype Co.*, 328 N.E.2d 505, 518 (Mass. 1975) ("The controlling group may not, consistent with its strict duty to the minority, utilize its control of the corporation to obtain special advantages and disproportionate benefit from its share ownership."); *Gunzberg v. Art-Lloyd Metal Prods. Corp.*, 492 N.Y.S.2d 83, 86 (Sup. Ct. 1985) ("Even if there were sound business reasons for the corporation's actions, it is clear that the ultimate beneficiary was [the controlling shareholder], not petitioners [minority shareholders]. Accordingly, petitioners adequately demonstrated that they were oppressed."); *Crosby v. Beam*, 548 N.E.2d 217, 221 (Ohio 1989) ("Control of the stock in a close corporation cannot be used to give the majority benefits which are not shared by the minority.").

The terminations of both the majority and the minority shareholders seem to eliminate any disproportionate benefit problem.¹⁵⁷ From a modified majority perspective, the mutual terminations are likely justified by the business purpose of reducing corporate expenses to account for the \$100,000 decline in corporate profits. Indeed, assume that the majority offers proof that the discharges will save the corporation \$100,000 (i.e., total salary expenses have been reduced from \$200,000 to \$100,000) plus sums generated by decreasing the number of employees from two to one (e.g., lower expenses for office space, lower expenses for employee health benefits, and lower coordination costs). Absent the less harmful alternative language, therefore, a modified majority court would likely conclude that no oppressive conduct has occurred.

From a modified minority perspective, however, the minority shareholder has lost the value of his close corporation employment—employment that may have induced his commitment of capital to the venture in the first place¹⁵⁸—through no misconduct or incompetence of his own. In such circumstances, modified minority courts may be willing to enforce a reasonable expectation of continued employment even though the majority shareholder is technically in the same terminated position. Indeed, the court's rationale in *In re Imperatore* reflects this possibility.¹⁵⁹ In *Imperatore*, John Imperatore was a twenty-percent shareholder in a close corporation that operated a transmission shop. Charles Fox and John Jordan owned the remaining eighty percent of the company's stock.¹⁶⁰ Because the corporation had allegedly fallen into poor financial condition, Fox and Jordan discontinued Imperatore's salary. Significantly, however, Fox discon-

157. It may be more accurate to state that the mutual terminations eliminate any "appearance" of disproportionate benefit. It is very likely that the majority shareholder is willing to terminate herself only because a comparable employment position is available to her, or because she has another source of income that diminishes her reliance upon salary. Indeed, the majority's own self-interest makes it unlikely that she would orchestrate the loss of her \$100,000 close corporation job unless she had a comparable opportunity with another business or had an outside source of income. Similarly, the minority shareholder's objection to his termination must stem from his inability to procure comparable employment and from his dependence on his salary. This hypothetical likely occurs, therefore, only because an underlying disproportionate benefit exists. In other words, this hypothetical likely occurs only because the loss of close corporation employment harms the majority shareholder less than the minority shareholder. See, e.g., *In re Imperatore*, 512 N.Y.S.2d 904, 905 (App. Div. 1987) (observing that the salaries of both the majority shareholder and the minority shareholder were discontinued, but noting that the majority shareholder earned an "independent income" from another business); *infra* text accompanying notes 159-63 (discussing *Imperatore*).

158. See *infra* notes 192-98 and accompanying text.

159. See *Imperatore*, 512 N.Y.S.2d at 905.

160. See *id.* at 904.

tinued his own salary as well.¹⁶¹ Despite the seemingly equivalent conduct,¹⁶² the *Imperatore* court concluded that the cessation of Imperatore's salary was oppressive and contrary to Imperatore's reasonable expectations:

[Imperatore] clearly agreed to join the venture pursuant to the understanding that he would be provided with salaried employment as the transmission shop's mechanic, and he reasonably expected such salaried employment to continue for so long as the corporation existed. While the petitioner could not reasonably complain if his salary were reduced based upon inadequate performance, in this case his salary was totally eliminated. . . . *The fact that Fox' salary was also terminated does not [affect the reasonableness of [Imperatore's] expectation that he would be provided with continuous salaried employment during the existence of the corporation.*¹⁶³

As *Imperatore* illustrates, modified majority and modified minority courts may reach different results in "no fault" situations even if the majority and minority shareholders both suffer the same fate.¹⁶⁴

When the less harmful alternative language is considered, however, a modified majority court may also determine that oppression liability is warranted despite the technical absence of disproportionate benefit. Assume, for example, that the minority shareholder contends that the same legitimate objective of eliminating corporate expenses could be accomplished by simply reducing the salary paid to each shareholder to \$50,000. The reduction in salary would accomplish the same business objective of saving \$100,000 in expenses (i.e., total salaries decrease from \$200,000 to \$100,000), and it would inflict less harm upon the minority (i.e., the minority retains its employment). Compared to the majority's conduct, however, the corporation is worse off under the minority's proposal because of the proposal's

161. *See id.* at 905.

162. The facts of *Imperatore* indicate that the apparent equivalence in ceasing Fox's and Imperatore's salary was illusory. Indeed, Fox "was apparently the owner with Jordan of another transmission shop from which he earned an independent income," while Imperatore's salary with the close corporation was his only source of income. *See id.* Thus, the loss of salary affected Imperatore much more than Fox. *See supra* note 157.

163. *Imperatore*, 512 N.Y.S.2d at 905 (emphasis added) (citations omitted).

164. *Imperatore* reflects aspects of both pure minority and modified minority approaches. Indeed, Fox and Jordan maintained that the corporation had fallen into poor financial condition "largely as a result of the petitioner's ineffective performance in his job as 'technical man.'" *Id.* The court reflected a modified minority perspective by observing that Imperatore's salary could be "reduced based upon inadequate performance." *Id.* When discussing the complete elimination of Imperatore's salary, however, the court reflected a pure minority perspective by granting relief and by seemingly ignoring Imperatore's inadequacies. *See id.* (concluding that Imperatore's reasonable expectation of "continuous salaried employment" was frustrated, and noting that "[w]hile the petitioner could not reasonably complain if his salary were reduced based upon inadequate performance, in this case his salary was totally eliminated").

inability to capture the additional downsizing-related savings.¹⁶⁵ If a court determines that this worsened corporate position is irrelevant to the less harmful alternative analysis, the modified majority perspective would also conclude that the termination was oppressive.¹⁶⁶ If the minority's proposal is rejected because of its relative corporate detriment, however, the differences in outcome between the two perspectives would remain.¹⁶⁷

In short, when the modified perspectives are applied to a "no fault" scenario, there is a strong possibility that the perspectives will produce different outcomes. As a consequence, the choice of oppression perspective is critical.

5. Summary

Although the modified formulations narrow the gap between the majority and minority perspectives of oppression, the possibility of differences in outcome remains. Indeed, the language of existing precedents suggests that courts may draw different conclusions in particular scenarios depending solely upon the oppression perspective utilized. Because real and hypothetical cases reveal distinctions between the oppression formulations, moving beyond the "not contradic-

165. As mentioned, decreasing the number of employees from two to one lowers coordination costs and reduces expenses associated with office space and health benefits. *See supra* text accompanying notes 157-58.

166. That is, a modified majority court would conclude that an alternative to mutual terminations existed (i.e., proportionate reductions in salary) that would cause less harm to the minority shareholder. As a consequence, the majority's decision to terminate would be considered oppressive.

167. Even this conclusion can be questioned. If a less harmful alternative must be economically equivalent, from the corporation's standpoint, to the majority's conduct, a minority shareholder may still prevail in this hypothetical. Indeed, the minority shareholder could propose several alternative courses of action that would be economically equivalent to the majority's conduct and that would allow the minority to retain its job. Put differently, the minority could propose several alternatives that would (1) reduce salary expenses by \$100,000; (2) capture downsizing-related savings; and (3) allow the minority to retain its job. For example, rather than reducing the salary paid to each shareholder by only \$50,000, the minority shareholder could propose proportionate reductions in salary by an amount equal to the total expenses saved by the majority's conduct. In other words, rather than reducing total salaries only by \$100,000, the minority could propose reducing total salaries by \$100,000 plus the amounts saved from downsizing (assuming those amounts can be quantified). Similarly, along with proposing a \$50,000 decrease in the salary paid to each shareholder, the minority could offer to forego its health benefits and, to the extent possible, its office space. Aside from the savings resulting from decreased coordination costs, this course of action is economically equivalent to the majority's conduct. Finally, the minority could simply propose that the majority terminate only herself. Such an action would reduce corporate expenses by \$100,000 and would entirely capture the savings from downsizing. While many of these proposals seem ludicrous, they derive directly from the less harmful alternative restriction and from the uncertainty generated by the restriction's potential construction.

tory" and "little difference" perspectives is appropriate. The perspectives should be understood as clearly different approaches to the shareholder oppression doctrine that can produce divergent results upon the same set of facts. The remaining question, therefore, is a significant one—from which perspective should shareholder oppression be viewed?

V. BALANCING INVESTMENT PROTECTION AND MAJORITY PREROGATIVES: THE SUPERIORITY OF THE MODIFIED MINORITY PERSPECTIVE

Understanding the purpose of the shareholder oppression doctrine is critical to an assessment of the different oppression perspectives. After all, without a sense of what the shareholder oppression doctrine is attempting to accomplish, there is no benchmark for evaluating the operation of the perspectives. This Article maintains that shareholder oppression should be viewed as a doctrine concerned with protecting the fair value of a close corporation shareholder's investment. Such a conception, referred to as the "investment model" of oppression,¹⁶⁸ will generally find oppression liability whenever majority conduct harms any component of a minority shareholder's investment. To some extent, however, this investment model of oppression must yield to a majority prerogative to run the business as it sees fit. The oppression doctrine, in other words, must attempt to balance both majority and minority concerns in its operation. Not surprisingly, striking the appropriate balance between these concerns is a difficult undertaking. Before exploring this difficulty, however, a basic understanding of the investment model is needed.

A. *The Investment Model of Oppression*

1. The Absence of a Market

Both courts and commentators have noted that the shareholder oppression doctrine is best understood by examining the "special nature of close corporations."¹⁶⁹ That "special nature" is linked primarily

168. See generally Moll, *supra* note 29, at 537-47 (developing the "investment model" of oppression and arguing that shareholder oppression should be viewed as a doctrine that protects the value of the close corporation shareholder's investment).

169. *In re Topper*, 433 N.Y.S.2d 359, 364 (Sup. Ct. 1980) (noting that "to a great extent, a definition of 'oppressive' depends on the special nature of close corporations"); accord 2 O'NEAL, *CLOSE CORPORATIONS*, *supra* note 14, § 9.30, at 142; see also Balvik v. Sylvester, 411 N.W.2d 383, 386 (N.D. 1987) ("The statutory concept of oppressive conduct, and the broad and imprecise

to the lack of a market for close corporation shares.¹⁷⁰ Indeed, if the position of a public corporation shareholder is harmed by the principle of majority rule, the public shareholder can exit the situation by selling his holdings on the market. Because a "market exit" generally protects the fair value of a public company investment,¹⁷¹ a public corporation shareholder is adequately safeguarded from oppressive majority conduct.¹⁷²

In the close corporation context, however, there is no market exit.¹⁷³ Thus, the close corporation shareholder "faces a potential danger that the shareholder of a public corporation generally avoids—the possibility of harm to the fair value of the shareholder's investment."¹⁷⁴ At its extreme, this harm manifests itself as the classic freeze-out where the minority shareholder faces a trapped investment¹⁷⁵ and an

definitions of the term given by the courts, is best understood by examining the nature and characteristics of close corporations.").

170. See, e.g., Kleinberger, *supra* note 33, at 1149 (discussing the lack of a market for close corporation stock and observing that "[m]ore than any other characteristic, this 'no exit' phenomenon has pushed the law into developing special rules for shareholders in close corporations").

171. See I O'NEAL, *OPPRESSION*, *supra* note 14, § 2:15, at 38 (observing that "in a public-issue corporation the sensitivity of management to the market price for the stock and the fact that stock prices are highly responsive to corporate earnings tend to assure the dissatisfied shareholder of a reasonable price when he liquidates his investment through the market" (quoting J.A.C. Hetherington, *Special Characteristics, Problems, and Needs of the Close Corporation*, 1969 ILL L.F. 1, 21); *id.* (noting that "in a large public-issue corporation, a shareholder who is dissatisfied with the way the business is being operated can sell his stock at no great financial loss").

172. See RMBCA § 14.34 cmt. (1993) ("Shareholders of publicly-traded firms are protected by their right to sell out if they are dissatisfied with current management or they may seek traditional remedies for breach of fiduciary duty."); Thompson, *supra* note 37, at 225 ("Once a corporation's shares are publicly traded, minority shareholders, even if they are also employees, are not subjected to the risks that are common to the close corporation and which inspired the modern legislative and judicial remedies."); *id.* at 237 (noting that the market offers public corporation shareholders "protection" and an "exit option").

173. See *supra* note 48 and accompanying text.

174. Moll, *supra* note 29, at 543.

175. See, e.g., *Brenner v. Berkowitz*, 634 A.2d 1019, 1027 (N.J. 1993) ("The inability to reflect dissatisfaction by withdrawing one's investment places the majority shareholder in an enhanced power position to use the minority's investment 'without paying for it.'") (quoting Arthur D. Spratlin, Jr., *Modern Remedies for Oppression in the Closely Held Corporation*, 60 MISS. L.J. 405, 405 (1990)); *Balvik v. Sylvester*, 411 N.W.2d 383, 386 (N.D. 1987) ("The limited market for stock in a close corporation and the natural reluctance of potential investors to purchase a noncontrolling interest in a close corporation that has been marked by dissension can result in a minority shareholder's interest being held 'hostage' by the controlling interest, and can lead to situations where the majority 'freeze out' minority shareholders by the use of oppressive tactics."); Schlafge, *supra* note 28, at 1076 ("The terminated minority shareholders' capital is, in effect, held hostage by those in control of the corporation because there is no marketplace in which minority shareholders may sell their shares.").

indefinite exclusion from participation in the business returns.¹⁷⁶ The position of the close corporation shareholder, therefore, is uniquely precarious. As one commentator noted, “[i]n no other type of business arrangement do owners face the possibility of completely losing their investments by being excluded from employment and denied profits.”¹⁷⁷

“If oppression is to be given meaning in light of the ‘special nature’ of close corporations, the absence of a market should be viewed as the primary impetus for the development of the oppression doctrine in the close corporation setting.”¹⁷⁸ Protecting the value of the close corporation shareholder’s investment, therefore, should be understood as the focus of the shareholder oppression doctrine. The doctrine, in other words, should approximate the role of the market in the public corporation. Just as the market protects the value of the public corporation shareholder’s investment, the oppression doctrine should protect the value of the close corporation shareholder’s investment.

2. The Purpose of Involuntary Dissolution Statutes

Along with examining the “special nature” of close corporations, courts have also noted that inquiring into “the Legislature’s general purpose in creating . . . involuntary-dissolution statute[s]” is helpful in giving meaning to the oppression doctrine.¹⁷⁹ As mentioned, the dissolution statutes of many states include “oppression” as a ground for involuntary dissolution of a corporation.¹⁸⁰ In the leading New York case of *In re Kemp & Beatley, Inc.*, the court of appeals discussed the purpose behind the legislature’s inclusion of “oppressive actions” as an involuntary dissolution ground:

As the stock of closely held corporations generally *is not readily salable*, a minority shareholder at odds with management policies may be without either a voice in protecting his or her interests or any reasonable means of withdrawing his or her investment. *This predicament may fairly be considered the legislative concern underlying the*

176. See *supra* note 46 and accompanying text.

177. Schlafge, *supra* note 28, at 1074 n.19; see also Hetherington & Dooley, *supra* note 1, at 6 (“The position of the minority in the close corporation is as unique as it is precarious: no other form of business organization 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.”); cf. 1 O’NEAL, CLOSE CORPORATIONS, *supra* note 14, § 7.20, at 90 (“[T]he lack of a market for the shares of a close corporation . . . leaves a minority shareholder vulnerable in a way that is distinct from the position of a shareholder in a publicly held corporation.”).

178. Moll, *supra* note 29, at 544; *supra* note 170.

179. *In re Kemp & Beatley, Inc.*, 473 N.E.2d 1173, 1178 (N.Y. 1984); see 2 O’NEAL, CLOSE CORPORATIONS, *supra* note 14, § 9.30, at 141-42 (noting that “most courts have come to recognize that [oppression and similar terms] can best be construed against the background of the special nature of close corporations and the legislative purpose in enacting involuntary dissolution statutes”).

180. See *supra* note 50 and accompanying text.

*provision at issue in this case; inclusion of the criteria that the corporation's stock not be traded on securities markets and that the complaining shareholder be subject to oppressive actions supports this conclusion.*¹⁸¹

The language of the *Kemp* court strongly suggests that the vulnerability of the close corporation investment was the primary motivation behind the inclusion of the "oppressive actions" language in the involuntary dissolution statute. The purpose of the statute and the "oppressive actions" ground, therefore, was to provide the shareholder's investment with some protection in this vulnerable situation.¹⁸² To the extent that the purpose of the statute gives meaning to the oppression action, protecting the close corporation shareholder's investment is central to the operation of the doctrine.

3. The Prevalence of the Buyout Remedy

As mentioned, both legislatures and courts have authorized alternative remedies for oppressive conduct that avoid actual dissolution of the corporation.¹⁸³ The most prevalent alternative remedy is the buyout of the oppressed investor's holdings.¹⁸⁴ The prevalence of the buyout remedy in litigated cases supports the investment model's conception of shareholder oppression as a protector of the close corpo-

181. *Kemp*, 473 N.E.2d at 1179 (emphasis added); *see also id.* at 1180 ("The purpose of this involuntary dissolution statute is to provide protection to the minority shareholder whose reasonable expectations in undertaking the venture have been frustrated and who has no adequate means of recovering his or her investment.").

182. Indeed, dissolution aids the oppressed close corporation shareholder to the extent that it provides a mechanism for recovering the value of the shareholder's investment. The conventional dissolution proceeding determines the value of a business and awards each stockholder its proportional share of that value. *See* Murdock, *supra* note 46, at 447-51 (discussing different valuation approaches to dissolution and their effect upon the value of the minority shareholder's interest). A *Kemp*-like dissolution statute, therefore, is designed to protect the value of a close corporation shareholder's investment. *See* N.Y. BUS. CORP. LAW § 1104-a(b) (McKinney 1986) (amended 1998) (stating that a court, "in determining whether to proceed with involuntary dissolution . . . shall take into account: (1) Whether liquidation of the corporation is the only feasible means whereby the petitioners may reasonably expect to obtain a fair return on their investment" (emphasis added)); *Exadaktilos v. Cinnaminson Realty Co.*, 400 A.2d 554, 560 (N.J. Super. Ct. Law Div. 1979), *aff'd*, 414 A.2d 994 (N.J. Super. Ct. App. Div. 1980) ("[I]n most instances the market place provides a remedy for those shareholders who feel that they are being oppressed by a large corporation, *i.e.*, they can sell their stock. That remedy is not readily available to minority shareholders in close corporations. *The [oppression-based dissolution] statute was designed therefore to solve a problem peculiar to them.*" (emphasis added)).

183. *See supra* notes 51-53 and accompanying text.

184. *See* Murdock, *supra* note 46, at 470 ("The most common form of alternative remedy is the buy-out of the minority shareholder."); 1 O'NEAL, CLOSE CORPORATIONS, *supra* note 14, § 1.16, at 97 (noting that buyouts "are the most common remedy for dissension within a close corporation" (emphasis added)); *see also* Thompson, *supra* note 37, at 231 ("The increased use of buyouts as a remedy is the most dramatic recent change in legislative and judicial thinking on close corporations problems.").

ration investment. By ordering a buyout of the minority's interest at "fair value,"¹⁸⁵ the courts are effectively replicating a market for close corporation minority interests and are allowing oppressed shareholders to "cash out" of the business. Because the buyout remedy seeks to provide the close corporation shareholder with the "fair value" of his investment, it is logical to assume that the doctrine triggering the remedy is concerned with protecting the fair value of that investment.

In summary, the absence of a developed market, the purpose of involuntary dissolution statutes, and the prevalence of the buyout remedy all support a conception of oppression as a doctrine that protects the fair value of a close corporation shareholder's investment. This "investment model" of oppression sheds light on the underlying purposes of the doctrine and provides a context for evaluating the various oppression perspectives.

B. The Components of a Close Corporation Investment

Although the investment model suggests that shareholder oppression protects the close corporation investment, there is still a question about how that investment is defined. It is critical to understand that the components of a close corporation investment generally differ from the components of a public corporation investment. In a public corporation, the shareholder commits her capital with the expectation that her investment entitles her to a proportionate share of the company's earnings.¹⁸⁶ Accordingly, the public corporation shareholder understands that her investment return will be comprised solely of financial sums reflecting this proportionate share (e.g., dividend payments).¹⁸⁷ Put differently, "[t]he shareholder of a publicly

185. The buyout statutes in several of the large commercial states are phrased in terms of "fair value." See Thompson, *supra* note 35, at 718 (noting that "[s]everal of the largest commercial states permit a corporation or its majority shareholders to avoid involuntary dissolution by purchasing the shares of the petitioning shareholders at their 'fair value' "); see also RMBCA § 14.34(a) (1993) ("In a proceeding under 14.30(2) to dissolve a corporation . . . the corporation may elect or, if it fails to elect, one or more shareholders may elect to purchase all shares owned by the petitioning shareholder at the fair value of the shares." (emphasis added)).

186. A 12 percent shareholder, for example, expects that her investment entitles her to 12 percent of the corporation's profits.

187. See, e.g., *Exadaktilos*, 400 A.2d at 560 ("Large corporations are usually formed as a means of attracting capital through the sale of stock to investors, with no expectation of participation in corporate management or employment. Profit is expected through the payment of dividends or sale of stock at an appreciated value."); Terry A. O'Neill, *Self-Interest and Concern for Others in the Owner-Managed Firm: A Suggested Approach to Dissolution and Fiduciary Obligation in Close Corporations*, 22 SETON HALL L. REV. 646, 663 (1992) ("The shareholder of a publicly traded corporation may realize a return on her investment in either of two ways: directly, by a distribution of dividends, or indirectly, by an increase in the market value of her shares."); see also ROBERT W. HAMILTON & RICHARD A. BOOTH, BUSINESS BASICS FOR LAW

traded corporation invests money . . . with a view to receiving money, as opposed to steady employment or associational benefits, in return."¹⁸⁸ In a close corporation, however, the shareholder typically commits his capital with the expectation that his investment entitles him to employment and to a management role, as well as to a proportionate share of the company's earnings.¹⁸⁹ Thus, a close corporation shareholder usually understands that his investment return will be comprised of employment benefits, management participation, and financial sums reflecting a share of the company's earnings.¹⁹⁰ The

STUDENTS: ESSENTIAL TERMS AND CONCEPTS § 8.6, at 200 (2d ed. 1998) ("[T]he payment of a dividend is also the basic way in which investors receive their financial return (short of selling their stock or interest or of the company liquidating).").

188. O'Neill, *supra* note 187, at 663; *see also* Schlafge, *supra* note 28, at 1073 n.14 (noting that the interest of the public corporation shareholder is "limited to the amount of their dollar investment in their shares, which can be sold at any time on the public market, and is not tied to their salary and other employment benefits"); *supra* note 187.

189. *See, e.g., Exadaktilos*, 400 A.2d at 561 ("Unlike their counterparts in large corporations, [close corporation minority shareholders] may expect to participate in management or to influence operations, directly or indirectly, formally or informally. Furthermore, there generally is an expectation on the part of some participants that their interest is to be recognized in the form of a salary derived from employment with the corporation." (citation omitted)); *Balvik v. Sylvester*, 411 N.W.2d 383, 386 (N.D. 1987) ("[I]t is generally understood that, in addition to supplying capital and labor to a contemplated enterprise and expecting a fair return, parties comprising the ownership of a close corporation expect to be actively involved in its management and operation."); Schlafge, *supra* note 28, at 1077 n.29 ("Both [public corporation and close corporation] investors expect appreciation in the value of their investment. Investors in publicly held corporations receive dividends as a form of return on this investment, while investors in closely held corporations may expect to receive a salary and a management position as a *condition* of their investment.") (emphasis added); *see also* *Michaud v. Morris*, 603 So. 2d 886, 888 (Ala. 1992) ("Certain basic expectations of investors are enforceable in the courts, and among those is a right to share proportionally in corporate gains."); *Bahls*, *supra* note 14, at 330 ("Shareholders in close corporations expect proportional distribution of the earnings of the corporation while it is operating."); *supra* note 36 and accompanying text; *infra* notes 190, 192-98 and accompanying text.

190. *See, e.g., Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657, 662 (Mass. 1976) ("The minority stockholder typically depends on his salary as the principal return on his investment. . . ."); *Bonavita v. Corbo*, 692 A.2d 119, 124 (N.J. Super. Ct. Ch. Div. 1996) ("[E]mployment is, of course, a frequent and perfectly proper benefit of stockholders in a close corporation."); *id.* at 126 (noting that "the primary benefit that [the defendant close corporation shareholder] receives from the corporation is continued employment for himself and his family"); *Ingle v. Glamore Motor Sales, Inc.*, 535 N.E.2d 1311, 1319 (N.Y. 1989) (Hancock, J., dissenting) ("A person who . . . buys a minority interest in a close corporation does so not only in the hope of enjoying an increase in value of his stake in the business but for the assurance of employment in the business in a managerial position."); *Baker v. Commercial Body Builders, Inc.*, 507 P.2d 387, 397 (Or. 1973) ("It is also true that the Bakers, as stockholders, had a legitimate interest in the participation in profits earned by the corporation."); 1 O'NEAL, CLOSE CORPORATIONS, *supra* note 14, § 1.08, at 32 ("Even if shareholders in a close corporation anticipate an ultimate profit from the sale of shares, they usually expect (or perhaps should expect) to receive an immediate return in the form of salaries as officers or employees of the corporation rather than in the form of dividends on their stock."); *Murdock*, *supra* note 46, at 468 ("The courts have recognized the reality that compensation paid to those in control has a two fold function: to recompense services

components of a close corporation investment, therefore, should be viewed as much broader than the components of a public corporation investment. As a consequence, the shareholder oppression doctrine must concern itself with protecting much more than the investor's proportionate share in the success of the company.¹⁹¹

Significantly, for many close corporation investors, the desire for employment (and, to some extent, management participation) is the principal enticement motivating their decision to commit capital to the venture.¹⁹² Indeed, a close corporation job carries significant benefits with it that are generally absent from other types of employment. First, as the owners of a small company, close corporation sharehold-

and to provide a return on investment."); Ragazzo, *supra* note 19, at 21 (noting that a close corporation shareholder "often invests for the purpose of having a job, and the salary and other benefits he receives is conceived to be part of the return on his investment"); *id.* at 18 ("In a closely held corporation, a shareholder who is also an employee has interests in his job and stock that are often economically intertwined."); *id.* at 21 ("[T]he discharge of an employee in a closely held corporation usually involves appropriation of a portion of his investment as a shareholder."); Schlafge, *supra* note 28, at 1094 ("Section 302A.751 [the Minnesota statute protecting minority shareholders] recognizes that shareholders in a closely held corporation legitimately expect a return of their investment, often in the form of a management position and a salary."); *see also supra* note 189 and accompanying text.

191. *Cf. Meiselman v. Meiselman*, 307 S.E.2d 551, 565 (N.C. 1983) (rejecting an argument that a close corporation shareholder is entitled to relief only when "traditional shareholder rights" have been infringed: "While it may be true that a shareholder in . . . a publicly held corporation may have 'rights or interests' defined as defendants argue, a shareholder's rights in a closely held corporation may not necessarily be so narrowly defined. . . . Put another way, [a close corporation shareholder's] 'reasonable expectations' are not as limited as defendants contend").

192. *See, e.g., In re Kemp & Beatley, Inc.*, 473 N.E.2d 1173, 1178 (N.Y. 1984) ("As a matter of fact, providing employment for himself may have been the principal reason why he participated in organizing the corporation.") (quoting F. HODGE O'NEAL, O'NEAL, CLOSE CORPORATIONS § 1.07, at 21-22 (2d ed. 1971)); 1 O'NEAL, CLOSE CORPORATIONS, *supra* note 14, § 1.08, at 31-32 ("Providing for employment may have been the principal reason why the shareholder participated in organizing the corporation."); *see also Wilkes*, 353 N.E.2d at 662 ("A guaranty of employment with the corporation may have been one of the 'basic reason[s]' why a minority owner has invested capital in the firm.") (quoting Symposium, *The Close Corporation*, 52 NW. U. L. REV. 345, 392 (1957)); *In re Wiedy's Furniture Clearance Ctr. Co.*, 487 N.Y.S.2d 901, 903 (App. Div. 1985) ("Although the exact amount of the capital contribution is disputed, petitioner utilized his own funds in getting this new venture underway, not simply as an investment, but to provide employment and a future for himself"); Alyse J. Ferraro, Note, *Ingle v. Glamore Motor Sales, Inc.: The Battle Between Ownership and Employment in the Close Corporation*, 8 HOFSTRA LAB. L.J. 193, 215 (1990) ("As the majority emphasizes, Ingle was compensated for the sale of his shares, but to believe that the dollar amount received met his expectations would be to dismiss his purpose in acquiring those shares. Ingle had reasonably expected his employment to continue until he chose to retire or to acquire his own Ford dealership . . ."); Murdock, *supra* note 46, at 468 ("That people often invest in a closely held corporation to provide a job is almost self-evident . . ."); *id.* ("To deny a minority shareholder employment when a job was part of his rationale in investing is oppressive, as is the failure to pay dividends to nonemployee shareholders when employed shareholders are receiving *de facto* dividends through salaries." (emphasis added) (footnote omitted)); *id.* at 472 ("[W]hat is at stake in the 'oppression' cases is often a job—a very attractive job."); Ragazzo, *supra* note 19, at 21 (noting that a close corporation shareholder "often invests for the purpose of having a job").

ers are generally able to pay themselves a higher salary than they would earn in comparable non-ownership positions.¹⁹³ Second, the principal shareholders of a close corporation often agree to parcel out the officer and other high-level management positions to themselves.¹⁹⁴ This assurance of a high-level management role is valuable, as it is generally associated with greater salary and prestige.¹⁹⁵ Finally, close corporation employment typically carries the intangible benefits of owning a business and working for oneself.¹⁹⁶ These intangible benefits may be significant in comparison to employment as a subordinate in someone else's company. Thus, the loss of a close corporation job may inflict great harm upon a shareholder, even if that shareholder is still receiving his proportionate share of the company's earnings.¹⁹⁷ Put

193. See 1 O'NEAL, *OPPRESSION*, *supra* note 14, § 3:07, at 70 n.6 (noting that "the special prerogatives enjoyed by a majority in a close corporation not infrequently block the sale of a close corporation because the majority has difficulty obtaining such lucrative employment elsewhere" (citing Hetherington, *supra* note 171, at 20 n.72); SHANNON P. PRATT, ROBERT F. REILLY, & ROBERT P. SCHWEIHS, *VALUING A BUSINESS: THE ANALYSIS AND APPRAISAL OF CLOSELY HELD COMPANIES* 121 (3d ed. 1996) ("It is not uncommon to find an owner/manager of a successful closely held company earning a greater amount in annual compensation than the amount an equivalent nonowner employee would earn as compensation."); see also *Bonavita*, 692 A.2d at 124 ("[W]hile there is no claim that the [close corporation] salaries are excessive, neither was there a showing that if the 'inside' employment were terminated those family members could earn as much elsewhere."); *Nelson v. Martin*, 958 S.W.2d 643, 644 (Tenn. 1997) (noting that the annual compensation of a shareholder-employee of a commercial printing business "was in excess of \$250,000"). This proposition, of course, assumes a comparison between similar jobs in businesses at similar stages of development.

194. See, e.g., *Wilkes*, 353 N.E.2d at 659-60 & n.9 (observing that all of the close corporation participants were directors of the company and that the offices of president, treasurer, and clerk were held by each of the participants over the years); *Balvik v. Sylvester*, 411 N.W.2d 383, 384 (N.D. 1987) (noting that both participants in a close corporation were directors of the company and observing that one shareholder-employee served as the president while the other served as the vice-president).

195. See O'NEAL, *OPPRESSION*, *supra* note 14, § 3:07, at 67 (referring to the "prestige, privileges, and patronage that come from controlling a corporation and occupying its principal offices"); cf. *id.* § 3:06, at 47 ("[L]osing the prestige of a directorship may be of considerable consequence to the shareholder.").

196. See *Ingle v. Glamore Motor Sales, Inc.*, 535 N.E.2d 1311, 1319 (N.Y. 1989) (Hancock, J., dissenting) (noting "the challenge, the independence, the prestige, the feeling of achievement, and the other intangible benefits of being part of the management of a successfully run small company"); *Bahls*, *supra* note 14, at 290-91 (noting that close corporation ownership includes "the social status and challenge of operating one's own company and the satisfaction of providing employment to one's children"); *id.* at 319 n.212 (mentioning the "loss of satisfaction and other qualitative perks associated with operating a business"); O'Neill, *supra* note 187, at 668, 671 (describing the "psychological payoffs" that an "owner-manager" anticipates as a result of investing in a venture, including "the pleasure of being one's own boss, the feeling of satisfaction in creating a viable enterprise and even the excitement of taking a substantial risk"); cf. *Bonavita*, 692 A.2d at 124 ("[O]f course, a job in the family business probably provides considerably more security than one might find in other employment.").

197. Close corporations often distribute their corporate earnings through salary and other job-related benefits rather than through the declaration of dividends. See *supra* note 44 and

differently, the loss of a close corporation job “may eliminate a unique employment position that was fundamental to the shareholder-employee’s decision to commit capital to the venture.”¹⁹⁸

C. Constructing Hypothetical Investment Bargains

If protecting the investment was the only relevant policy objective of the shareholder oppression doctrine,¹⁹⁹ the pure minority perspective would clearly be preferable given its operation as an absolute protector of minority interests.²⁰⁰ Majority shareholders, however, also have interests that must be factored into the analysis. Indeed, an effort to balance the majority’s interest in making business decisions against the minority’s interest in protecting the investment should be seen as an important aspect of the doctrine’s operation.²⁰¹ Thus, the oppression inquiry reduces to the following difficult question: to what extent should the shareholder oppression doctrine sacrifice protecting the minority’s investment in order to further the majority’s interest in running the business as it sees fit? To answer this question, one must

accompanying text. When a shareholder is terminated from employment, therefore, the shareholder may be cut off from her proportionate share of the corporate earnings. See *Nagy v. Riblet Prods. Corp.*, 79 F.3d 572, 577 (7th Cir. 1996) (“Many closely held firms endeavor to show no profits (to minimize their taxes) and to distribute the real economic returns of the business to the investors as salary. When firms are organized in this way, firing an employee is little different from canceling his shares.”) (emphasis added); *Landorf v. Glottstein*, 500 N.Y.S.2d 494, 499 (Sup. Ct. 1986), *aff’d*, 511 N.Y.S.2d 776 (App. Div. 1987) (“In a close corporation, since dividends are often provided by means of salaries to shareholders, loss of salary may be the functional equivalent of the denial of participation in dividends.”). It is critical to recognize, however, that significant harm may result from the loss of a close corporation job even if the investor is still receiving a proportionate share of the corporate earnings through dividends or other non-employment mechanisms. Close corporation employment, in other words, has value beyond its use as a vehicle for distributing the earnings of the business. Having a close corporation job, in and of itself, has significant value that often induces a shareholder’s commitment of capital to the venture. See *Moll*, *supra* note 29, at 548-51; *supra* notes 192-96 and accompanying text.

198. *Moll*, *supra* note 29, at 550; see also *Ragazzo*, *supra* note 19, at 19-20 (observing that “[i]n many cases, a shareholder in a closely held corporation expects to receive . . . compensating benefits through employment,” and describing the benefits of close corporation employment).

199. See *supra* Part V.A.

200. See *supra* text accompanying notes 83, 96.

201. See, e.g., *Muellerberg v. Bikon Corp.*, 669 A.2d 1382, 1387 (N.J. 1996) (noting that “minority shareholders’ expectations must . . . be balanced against the corporation’s ability to exercise its business judgment and run its business efficiently”); *Meiselman v. Meiselman*, 307 S.E.2d 551, 572 (N.C. 1983) (Martin, J., concurring) (observing that the oppression inquiry requires “a consideration and balancing of all the circumstances of the case in determining whether relief should be granted and, if so, the extent, nature and method of such relief”); *Hillman*, *supra* note 27, at 60 (suggesting that an oppression standard should “develop a satisfactory method for balancing the competing interests and expectations of minority and majority shareholders”); *Miller*, *supra* note 98, at 258 (“The courts must balance the interests of minority shareholders against the majority’s interest in making business decisions and limiting the minority shareholder’s power.”).

make fundamental assumptions about the understandings that would have been reached by objectively reasonable close corporation shareholders if, at the inception of the venture,²⁰² they had bargained over how their investments should be protected.²⁰³

It is important to understand the purpose of constructing these hypothetical investment bargains. Compared to public corporation rules, both majority and minority perspectives of oppression impose greater restrictions on the majority's decision-making discretion.²⁰⁴ To

202. See *supra* notes 61, 70 and accompanying text.

203. See Frank H. Easterbrook & Daniel R. Fischel, *Close Corporations and Agency Costs*, 38 STAN. L. REV. 271, 293 (1986) ("If a court is unavoidably entwined in a dispute, it must decide what the parties would have bargained for had they written a completely contingent contract."); *id.* at 291 ("Properly interpreted, fiduciary duties should approximate the bargain the parties themselves would have reached had they been able to negotiate at low cost."); *id.* at 298 ("The right inquiry is always what the parties would have contracted for had transactions costs been zero."); see also *Nagy v. Riblet Prods. Corp.*, 79 F.3d 572, 577 (7th Cir. 1996) ("A 'fiduciary' duty to investor-employees, which protects the return on investment, then may approximate the terms the investors would have accepted had they bargained expressly."); EASTERBROOK & FISCHEL, *supra* note 48, at 246 ("Completely overlooked in all of this rhetoric was the basic question—which outcome would the parties have selected had they contracted in anticipation of this contingency?").

204. Indeed, under public corporation rules, courts rarely interfere with employment, management, and dividend decisions, as the business judgment rule is often invoked to protect the majority's discretion. See *infra* notes 284-85 and accompanying text. When these matters are challenged in the close corporation context, however, even a pure majority approach presumably subjects the majority's decision to greater scrutiny than a business judgment rule approach. Cf. *Smith v. Atlantic Properties, Inc.*, 422 N.E.2d 798, 801, 804 (Mass. App. Ct. 1981) (stating, in a close corporation dispute, that "[t]he judgment . . . necessarily disregards the general judicial reluctance to interfere with a corporation's dividend policy ordinarily based upon the business judgment of its directors"); O'Neill, *supra* note 187, at 692 ("The burden-shifting scheme devised in *Wilkes* effectively deprives majority shareholders of the protection of the business judgment rule by requiring close judicial scrutiny of the majority's action whenever the minority is harmed."); *id.* at 690 & n.155 ("Courts in some jurisdictions have refused to apply the business judgment rule to close corporations in an effort to correct the squeeze out problem" (citing *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657 (Mass. 1976)); *Donahue v. Rodd Electrotypes Co.*, 328 N.E.2d 505 (Mass. 1975)). But see *Peeples*, *supra* note 69, at 498 (noting that "[t]he first prong of the *Wilkes* test tracks the traditional business judgment rule analysis"). Indeed, under any majority perspective, a majority shareholder presumably has to *prove* that its motive for action is legitimate and is not pretextual. In contrast, under the business judgment rule, the majority shareholder need only *articulate* a rational business purpose for its conduct. See, e.g., Krishnan S. Chittur, *Resolving Close Corporation Conflicts: A Fresh Approach*, 10 HARV. J.L. & PUB. POL'Y 129, 154 (1987) ("So long as the controlling stockholder's conduct is not outrageous—that is, a plausible business reason can be articulated—his decisions are protected by the business judgment rule."); see also *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971) ("A board of directors enjoys a presumption of sound business judgment, and its decisions will not be disturbed if they can be attributed to any rational business purpose."); *Kamin v. American Express Co.*, 383 N.Y.S.2d 807, 809 (Sup. Ct.), *aff'd*, 387 N.Y.S.2d 993 (App. Div. 1976) (granting defendants' motion to dismiss on business judgment rule grounds); Chittur, *supra*, at 155 (noting that, under the business judgment rule, "[c]orporate management has never been obliged to disclose its true motivation, and can 'easily manufacture a 'legitimate' corporate purpose for its action' ") (footnote omitted) (quoting Gary G. Lynch & Marc I. Steinberg, *The Legitimacy of*

this extent, both perspectives recognize that the close corporation shareholder has distinctive expectations about his investment, and about the majority's discretion to affect his investment, that warrant special judicial treatment.²⁰⁵ The "superior" oppression perspective, however, is the perspective whose operation conforms most closely to these distinctive expectations. As a consequence, such expectations must be identified. This task is accomplished by constructing hypothetical investment bargains—i.e., by envisioning hypothetical bargaining sessions between reasonable close corporation shareholders over how their investments should be protected, and by deriving the likely understandings that would ultimately be reached at those sessions.²⁰⁶ Put differently, to convince the objectively reasonable investor to commit a substantial part of his savings to a close corporation,²⁰⁷ what understandings would the shareholders probably have to reach?

In wrestling with this question, it is important to recall that many close corporation investors—both majority and minority owners—see their investments as comprised of multiple components. The typical close corporation shareholder, in other words, expects that her return on investment will consist of employment benefits, management participation, and a proportionate share of the company's earnings.²⁰⁸ Given this proposition, it necessarily follows that reasonable close corporation shareholders would have reached at least three understandings if they had bargained at the venture's inception.

First, if reasonable close corporation shareholders had bargained about the possibility of a freeze-out, they would likely reach an understanding that a freeze-out is impermissible. Because of the importance of the investment, all of the shareholders presumably

Defensive Tactics in Tender Offers, 64 CORNELL L. REV. 901, 926 (1979)). Minority perspective courts, of course, clearly provide greater protection than the business judgment rule. Indeed, even if the majority proves that its motive for action is both legitimate and genuine, liability may still result if the minority's reasonable expectations are frustrated.

205. Indeed, the shareholder oppression doctrine represents a set of special judicial rules for close corporation disputes. See *supra* note 204. The majority and minority perspectives of oppression, therefore, simply reflect different approaches to this set of special rules. As mentioned, therefore, this Article is considering which approach to the special rules is superior, rather than whether the special rules should exist at all. See *supra* note 26 and accompanying text.

206. See *supra* note 203.

207. See, e.g., *Donahue*, 328 N.E.2d at 514 ("Typically, the minority stockholder in a close corporation has a substantial percentage of his personal assets invested in the corporation."); *In re Topper*, 433 N.Y.S.2d 359, 362 (Sup. Ct. 1980) (noting that a close corporation minority shareholder "put his life savings into the venture"); *EASTERBROOK & FISCHER*, *supra* note 48, at 237 (observing that "[i]nvestors in close corporations often put a great deal of their wealth at stake"); 1 O'NEAL, *OPPRESSION*, *supra* note 14, § 1:03, at 4 (noting that a close corporation investor "may put practically everything he owns into the business").

208. See *supra* notes 189-90 and accompanying text.

realize that theft of the investment, or any part of the investment, is intolerable.²⁰⁹ In the conventional freeze-out scenario, however, most (if not all) of the components of the shareholder's investment are effectively stolen with no justification.²¹⁰ In bargaining over the possibility of a freeze-out, therefore, it seems likely that minority shareholders would have refused to invest in the venture if the majority shareholder had insisted upon the retention of his freeze-out discretion. In other words, to appease the minority shareholders and to induce them to commit capital to the business, the majority shareholder would likely have had to promise that his freeze-out discretion would not be utilized.

Second, if reasonable close corporation shareholders had bargained over the possibility of "forfeiting" the employment and management aspects of their investments as a result of their own misconduct or incompetence, they would probably reach an understanding that such forfeiture is proper.²¹¹ Indeed, both majority and minority shareholders are likely to realize that a productive business

209. See, e.g., Bradley, *supra* note 101, at 840 ("Never should the minority participant be understood as assenting to the effective confiscation of his or her investment . . .").

210. See, e.g., Sugarman v. Sugarman, 797 F.2d 3, 7-8 (1st Cir. 1986); *In re Burack*, 524 N.Y.S.2d 457, 459-60 (App. Div. 1988); *In re Wiedy's Furniture Clearance Ctr. Co.*, 487 N.Y.S.2d 901, 903-04 (App. Div. 1985).

211. Although reasonable close corporation shareholders would likely agree that the employment and management aspects of their investments could be forfeited as a result of their own misconduct or incompetence, it does not necessarily follow that a "blameworthy" shareholder could also be denied his proportionate share of the corporate earnings or his other rights as a general stockholder. Indeed, from a minority perspective, there is a difference between a shareholder's general reasonable expectation of proportionately sharing in the corporate earnings, and a shareholder's specific reasonable expectation of an entitlement to certain benefits (e.g., employment, management participation). See Moll, *supra* note 29, at 553-56 (discussing the distinction between "general" and "specific" reasonable expectations). While misconduct or incompetence may cause a shareholder to "forfeit" his specific reasonable expectation of continued employment or management participation, such minority fault does not necessarily affect the shareholder's general reasonable expectation of sharing proportionately in the profits of the business. See, e.g., *Exadaktilos v. Cinnaminson Realty Co.*, 400 A.2d 554, 561-62 (N.J. Super. Ct. Law Div. 1979), *aff'd*, 414 A.2d 994 (N.J. Super. Ct. App. Div. 1980) (concluding that a minority shareholder's termination was not oppressive in light of the minority's "unsatisfactory performance," but noting that the minority's expectation of dividends was a separate issue that could potentially establish an independent oppression claim); *Gimpel v. Bolstein*, 477 N.Y.S.2d 1014, 1021 (Sup. Ct. 1984) ("The other shareholders need not allow [a minority shareholder who stole from the corporation] to return to employment with the corporation, but they must by some means allow him to share in the profits."); *id.* at 1022 (allowing a majority shareholder to terminate and exclude a minority shareholder who stole from the business, but ordering the majority to "either alter the corporate financial structure so as to commence payment of dividends, or else make a reasonable offer to buy out [the minority's] interest"). In majority perspective terms, it may be proper and justified to terminate the employment of a shareholder who has engaged in misconduct or incompetence, but it does not necessarily follow that it is also proper and justified to exclude that shareholder from his proportionate share of the corporate returns.

operation requires loyalty and competence from employees and managers. More importantly, objectively-speaking, people generally understand and assume the risk of negative consequences stemming from their own fault.²¹² It seems likely that if reasonable close corporation shareholders had bargained over the possibility of losing portions of their investments for misconduct or incompetence, the risk would have been considered tolerable and commitments of capital would still have been made.²¹³

212. The North Carolina decision of *Meiselman v. Meiselman*, 307 S.E.2d 551 (N.C. 1983), suggests a judicial acceptance of this proposition. In *Meiselman*, the Supreme Court of North Carolina construed a state statute that granted judges the “ ‘power to liquidate the assets and business of a corporation in an action by a shareholder when it is established’ that ‘[l]iquidation is reasonably necessary for the protection of the rights or interests of the complaining shareholder.’ ” *Id.* at 560 (quoting N.C. GEN. STAT. § 55-125(a)(4) (1955), amended by, § 55-14-30(2) (1999)). In construing the statute, the court noted that the aggrieved shareholder must prove that his “ ‘expectation has been frustrated’ ” and that “ ‘the frustration was *without fault of plaintiff* and was in large part beyond his control.” *Id.* at 564 (emphasis added); see *id.* at 572 (Martin, J., concurring) (“If it is determined that plaintiff’s rights or interests require protection because of plaintiff’s own conduct, it would be improper to grant equitable relief. He who seeks equity must do equity.”); see also *Brenner v. Berkowitz*, 634 A.2d 1019, 1029 (N.J. 1993) (“A court could reasonably determine that unfairness would result if a minority shareholder were permitted to seek judicial intervention after years of acquiescence or participation in the alleged misconduct.”); 1 O’NEAL, OPPRESSION, *supra* note 14, § 1:01, at 2 (“Minority shareholders may be so uncooperative and act so unreasonably and improperly that controlling shareholders are justified in moving to eliminate them from the enterprise”); 2 O’NEAL, OPPRESSION, *supra* note 14, § 7:15, at 94 n.15 (“ ‘As a practical matter, there is something anomalous about permitting a shareholder’s laziness, absenteeism and/or inefficiency to confront the controlling shareholders with a Hobson’s choice of retaining him at full pay or risking dissolution and all the adverse financial and tax consequences that come in its wake’ ” (quoting Letter from Joseph L. Hutner to F. Hodge O’Neal (May 5, 1990))); *Easterbrook & Fischel*, *supra* note 203, at 295 (“It is hard to imagine . . . how closely held corporations could function under a requirement that all shareholders have an ‘equal opportunity’ to receive salary increases and continue in office *regardless of their conduct.*” (emphasis added)); *Hillman*, *supra* note 27, at 55 (noting the “allocation of adverse economic consequences on the basis of fault” as a possible policy objective); *id.* at 77 (noting that a prerequisite for relief under an expectations-based analysis should be that “the failure to achieve the expectation was in large part beyond the control of the participant”); *id.* at 80 (“Requiring that the dissatisfied shareholder not be responsible for the failure to achieve his or her own expectations may appear to be one of the more arguable of the prerequisites for relief. The absence of such a condition, however, would enable a dissatisfied shareholder to obtain relief by simply sabotaging the expectations.”); *Miller*, *supra* note 98, at 233-34 (stating that “relief may be denied to minority shareholders whose behavior justifies the majority’s conduct”); *Sandra K. Miller, A Note on the Definition of Oppressive Conduct by Majority Shareholders: How Can the Reasonable Expectations Standard be Reasonably Applied in Pennsylvania?*, 12 J.L. & COM. 51, 68 (1992) (“The minority’s expectations may be frustrated where his misconduct is perceived as being the cause leading up to the frustration of his expectations.”); *Prentice*, *supra* note 90, at 145 (“Prima facie exclusion from corporate affairs should give rise to a remedy Circumstances might exist, however, justifying such exclusion. For example, where it can be proven that the excluded member was the author of his own fate then he should not be afforded any relief.”).

213. There may be some distinction between “willful” misconduct or incompetence and similar “non-purposeful” behavior. To the extent that willful misconduct or incompetence is within the control of the shareholder, it is likely that the reasonable shareholder would agree to assume

Third, and most importantly, if reasonable close corporation shareholders had bargained over an arrangement allowing their investments to be harmed whenever any legitimate business purpose was served, they would very likely reach an understanding that rejected such an arrangement.²¹⁴ Indeed, reasonable shareholders are apt to refuse to invest if they realize that their employment or management role can be eliminated whenever any corporate interest is furthered. Put differently, because close corporation shareholders view their investments as having three central components—an employment position, a management role, and a proportionate share of the company's earnings²¹⁵—it should not be assumed that reasonable shareholders would permit one investment component to be harmed for *any* benefit in another.

For example, assume that a majority shareholder terminates the employment of a 33% minority shareholder and vice president because the minority shareholder, although competent, can be replaced by a more efficient and less expensive machine. Assume further that there is evidence indicating that this replacement will allow the corporation to earn an additional \$10,000 in yearly profits. If the terminated vice president previously earned a \$100,000 salary in his close corporation position and can only obtain comparable employment at an \$80,000 salary, the termination has a very negative effect on the shareholder's overall investment value. Indeed, although the "company earnings" component of the shareholder's investment has increased by \$3,333 per year (33% of the \$10,000 in additional profits), the elimination of the employment component has resulted in a loss of at least \$20,000 per year.²¹⁶ Although the termination seems to serve a

the risk of forfeiting portions of his investment because of such purposeful behavior. It is not clear that the reasonable shareholder would assume a similar risk, however, if portions of the investment could be forfeited for non-purposeful conduct—i.e., for conduct that is beyond the control of the shareholder. For example, at the venture's inception, if the investors had discussed the possibility of termination due to a physical or mental disability that subsequently arises and that renders a shareholder unable to perform his job tasks, a reasonable shareholder may have declined to commit capital to the business if such a termination did not give rise to liability. When the risk of forfeiture is within the shareholder's control, in other words, it is much more likely that the reasonable shareholder would consider such a risk to be tolerable. When such a risk is outside of the shareholder's control, however, the risk may exceed tolerable bounds and the reasonable shareholder may decline to invest. See *infra* note 225 (discussing the potential differences in treatment arising from "willful" versus "non-willful" conduct).

214. This assumes, of course, a legitimate business purpose *not* stemming from the shareholders' own misconduct or incompetence. See *supra* notes 211-13 and accompanying text.

215. See *supra* notes 189-90 and accompanying text.

216. The reduced salary may not represent the only loss of value stemming from the termination. Assume that the second company does not name the former vice president to a director or officer position. The loss of such a position may result in a significant loss of prestige. Moreo-

legitimate business purpose—i.e., it increases corporate profits by \$10,000 a year—the minority shareholder's investment is severely damaged. If reasonable close corporation shareholders had bargained over this point at the inception of the venture, they would be unlikely to reach an understanding that allows their overall investment value to be harmed whenever any corporate purpose is served.²¹⁷ In fact, if the majority shareholder had insisted on such an understanding, it is likely that the reasonable minority shareholder would have refused to invest.²¹⁸ Once again, therefore, to convince minority shareholders to commit capital to the business, the majority shareholder would probably have had to concede his discretion to act in furtherance of any corporate purpose.

When employment is at issue, this proposition can be even more forcefully asserted. At a minimum, employment is typically a component of the close corporation shareholder's investment.²¹⁹ In many (if not most) cases, however, employment is the *principal* component of such an investment.²²⁰ Indeed, many close corporations are small start-up businesses that face a high risk of failure.²²¹ Because of

ver, to the extent that the former vice president is now working as a subordinate in someone else's company, his discharge has resulted in an additional loss of intangible value. See *supra* notes 194-97 and accompanying text. Thus, even if the majority shareholder declares a \$20,000 dividend to compensate the terminated minority shareholder for his \$20,000 reduction in salary, the termination may still have a negative effect on the minority's overall investment value.

At some point, of course, the proportional increase in corporate profitability will exceed the losses to the other components of the minority's investment. For example, if the termination-related losses of salary, prestige, and intangible value totaled \$30,000 a year, but the termination allowed the corporation to earn an additional \$120,000 in yearly profits, the minority shareholder would presumably have no objection to his termination of employment. Indeed, although the elimination of the employment component results in a \$30,000 annual loss to the minority shareholder, the termination has increased the corporate earnings component of the shareholder's investment by \$40,000 annually (33% of the \$120,000 in additional profits). Thus, the shareholder's overall investment has increased in value as a result of his termination. In actuality, of course, it is difficult (if not impossible) to quantify the termination-related losses of prestige and intangible value. The fact that the minority shareholder has sued over the termination, however, implies that the minority shareholder's overall investment did not increase in value as a result of the termination.

217. See Cox, *supra* note 144, at 635 ("On a matter as sensitive as defining the rights upon which the economic welfare of minority holders depends, there is every reason to believe that such holders would not be content to assign those rights for any purpose served by a transaction.")

218. Cf. Miller, *supra* note 212, at 77-78 ("An overly broad interpretation of business purpose could undermine the goals of the reasonable expectation standard.")

219. See *supra* notes 189-90 and accompanying text.

220. See *supra* note 192 and accompanying text.

221. See, e.g., MICHAEL E. GERBER, *THE E-MYTH REVISITED: WHY MOST SMALL BUSINESSES DON'T WORK AND WHAT TO DO ABOUT IT 2* (1995). As Gerber observes:

Businesses start and fail in the United States at an increasingly staggering rate. Every year, over a million people in this country start a business of some sort. Statistics tell us that by the end of the first year at least 40 percent of them will be out of business.

the uncertainty surrounding whether the business will have any earnings at all, let alone earnings growth or consistency,²²² the close corporation shareholder's initial decision to invest is often based primarily on the definitive benefits of close corporation employment, rather than on the speculative possibilities of earnings growth.²²³ In this context, one should not assume that the reasonable shareholder would have accepted an arrangement allowing her principal investment component to be damaged for any increase in the corporate wealth.

It is important to underscore that these hypothetical bargains, as well as the understandings resulting from them, are not based upon mere speculation. To the contrary, they all derive from a proposition that is well-established among courts and commentators—i.e., close corporation shareholders consider their investments to be comprised of multiple components.²²⁴ Once that proposition is accepted, the hypothetical bargains and resulting understandings logically follow. For example, if close corporation shareholders consider their investments to be comprised of employment, management participation, and a share of the corporate profits, the unjustified theft of one or more of those components would naturally be unacceptable. Similarly, to the

Within five years, more than 80 percent of them . . . will have failed. . . . [M]ore than 80 percent of the small businesses that survive the first five years fail in the second five.

Id. (footnote omitted); see also 1 O'NEAL, OPPRESSION, *supra* note 14, § 1:04, at 8 (describing close corporations as "small business enterprises"); U.S. SMALL BUS. ADMIN., THE ANNUAL REPORT ON SMALL BUSINESS AND COMPETITION 29 (1997) ("Fewer than half of all new firms are in operation after five years."); U.S. Small Bus. Admin., Office of Advocacy, *Small Business Answer Card* (last modified Apr. 20, 1999) ("Business turnover is the domain of small business.") <http://www.sbaonline.sba.gov/stats/ec_anscd.html>; O'Neill, *supra* note 187, at 668 n.84 ("The risk of failure of the small business enterprise is notoriously high."); Ragazzo, *supra* note 19, at 19 ("Small businesses are exceedingly risky enterprises with high failure rates.").

222. See, e.g., GERBER, *supra* note 221, at 2 (noting that "hundreds of thousands of people every year . . . pour their energy and capital—and life—into starting a small business and fail," and stating that "many others . . . struggle along for years simply trying to survive"); *supra* note 221.

223. See, e.g., *Donahue v. Rodd Electrotype Co.*, 328 N.E.2d 505, 514 (Mass. 1975) ("Typically, the minority stockholder in a close corporation has a substantial percentage of his personal assets invested in the corporation. The stockholder may have anticipated that his salary from his position with the corporation would be his livelihood." (citation omitted)); *Muellenberg v. Bikon Corp.*, 669 A.2d 1382, 1385 (N.J. 1996) (noting that participation in the business is the "principal source of employment and income" for many close corporation shareholders); 1 O'NEAL, CLOSE CORPORATIONS, *supra* note 14, § 1.08, at 31 (noting that a shareholder's participation in a close corporation is often his "principal or sole source of income"); 1 O'NEAL, OPPRESSION, *supra* note 14, § 1:03, at 4 ("[A close corporation shareholder] may put practically everything he owns into the business and expect to support himself from the salary he receives as a key employee of the company. Whenever a shareholder is deprived of employment by the corporation . . . he may be in effect deprived of his principal means of livelihood."); see also *supra* note 192 and accompanying text.

224. See *supra* notes 189-90 and accompanying text.

extent that each of the components is valuable, it logically follows that the shareholders would not tolerate an investor who willfully engages in conduct that damages the corporation and that correspondingly damages the corporate profitability components of their investments.²²⁵ Finally, the ability to *eliminate* one aspect of the investment for any increase in the corporate profitability component would run counter to the recognition that the overall value of the investment stems from the presence of all three components.

225. If the shareholder's misconduct or incompetence is not willful, however, difficult issues arise. See *supra* note 213. Once again, to the extent that corporate profitability is an element of the close corporation investment, it logically follows that the shareholders would not tolerate an investor who willfully engages in conduct that damages the corporation. Much of the case law upholding the termination of a close corporation shareholder is consistent with this notion, as the cases involve shareholders who purposefully engage in conduct detrimental to the corporation. See, e.g., *Exadaktilos v. Cinnaminson Realty Co.*, 400 A.2d 554, 561-62 (N.J. Super. Ct. Law Div. 1979), *aff'd*, 414 A.2d 994 (N.J. Super. Ct. App. Div. 1980) (noting "plaintiff's failure to . . . learn the business" and that plaintiff "quit on more than one occasion . . . without reason or notice"); *Gimpel v. Bolstein*, 477 N.Y.S.2d 1014, 1019-20 (Sup. Ct. 1984) (observing that plaintiff "stole from the corporation"); cf. *Hillman*, *supra* note 27, at 80 n.249 ("A different set of considerations arises when employment is available on reasonable terms but the shareholder is unwilling to perform services. The dissatisfied shareholder who has or had the ability to cause the achievement of his or her own expectations is not a proper subject for relief . . ."). Where the element of "willful" or "purposeful" conduct is absent, however, the position of the terminated shareholder is more sympathetic. For example, if a shareholder makes a good-faith effort to perform adequately in his job but ultimately proves to lack the intelligence necessary for the competent performance of his tasks, should a termination of the shareholder give rise to oppression liability? On the one hand, the shareholder's incompetence is solely his own fault. To the extent that allocating negative economic consequences on the basis of fault is an appropriate policy objective, see *id.* at 55, the terminated shareholder is undeserving of protection. On the other hand, the absence of willful conduct separates this shareholder from the purposeful activity at issue in the existing oppression precedents. As a consequence, it may be appropriate to view this type of case in a more favorable light. As one commentator observed:

Much more difficult issues arise when the shareholder is willing but not able to perform services for the enterprise because of a limitation not apparent at the inception of the relationship. This may be for any one of a number of reasons, including lack of a required skill or intellectual capacity, a physical or mental disability, or an inability to adapt to the business. Where the assumptions upon which the employment expectation is based are subsequently proven to be erroneous, and it is beyond the power of the participant to achieve that expectation, then providing relief is preferable to requiring that the participant continue to commit funds to an enterprise from which he or she will receive little or no benefit.

Id. at 81; see also *Hughes v. Sego Int'l Ltd.*, 469 A.2d 74, 77 (N.J. Super. Ct. App. Div. 1983). As the *Hughes* court noted:

The [trial] judge stated . . . that the reason for [the minority's] termination was . . . that the individual defendants were dissatisfied with the result of his sales efforts. Although [the trial judge] determined that plaintiff's termination was a good faith business judgment, . . . [the defendants'] dissatisfaction with [the minority] was not the result of any failure on [the minority's] part to perform his duties credibly and conscientiously. Thus, plaintiff's lack of effectiveness was not due to misconduct. Accordingly, the [trial] judge concluded . . . that the termination of [the minority's] employment under these circumstances constitutes oppressive conduct . . .

Id. (internal quotations omitted).

Because the hypothetical bargains and resulting understandings all stem from an established proposition, this Article maintains that the understandings should be accepted as valid and accurate statements about the rationale of shareholders who invest in close corporations. Indeed, the understandings capture the distinctive expectations held by the reasonable close corporation shareholder about his investment, and about the majority's ability to affect his investment. More precisely, this Article asserts that the understandings should be accepted as the presumptive terms of the business deal that typical close corporation shareholders make. When majority conduct runs counter to these mutually-understood "terms," the majority should be viewed as having breached the deal that was presumptively struck between the parties.²²⁶ As a consequence, oppression liability should arise.

D. Choosing the "Right" Perspective

If the understandings resulting from the hypothetical bargains reflect both the distinctive expectations of the reasonable close corporation shareholder and the presumptive terms of the business deal that typical close corporation shareholders make, then the superior oppression perspective is the one that conforms most closely to these understandings. The pure majority perspective fails in this regard, as it allows the shareholder's investment to be harmed for any corporate purpose.²²⁷ Indeed, the pure majority perspective gives no explicit consideration to the damage inflicted on the minority's interests. As long as a corporate purpose is found, minority shareholder relief is denied without any inquiry into the minority's plight.²²⁸

A pure minority perspective, on the other hand, gives short-shrift to the majority's legitimate expectation of running a productive

226. See Miller, *supra* note 212, at 54 (describing the reasonable expectations approach as a "departure from the bargain struck by the majority and minority shareholders"); see also *In re Topper*, 433 N.Y.S.2d 359, 366 (Sup. Ct. 1980) ("The Court may determine the understanding of the parties as to the role the complaining shareholder is expected to play from agreements and evidence submitted. The Court can then decide whether the controlling shareholders have acted contrary to that understanding or, in the language of the statute, 'have been guilty of oppressive actions toward the complaining shareholders.'"); Bahls, *supra* note 14, at 325 (noting that "expectations are reasonable when they provide a basis for the bargain"); Murdock, *supra* note 46, at 465 (noting that when applying the reasonable expectations standard, "the crux is not identifying a traditional wrong but rather identifying the basis of the bargain—what were the explicit or implicit conditions pursuant to which the parties associated themselves together in the corporate form").

227. See *supra* Part III.A.

228. See *supra* Part III.A.

business with competent and loyal associates. Once a minority shareholder establishes a basic understanding that was shared by everyone at the venture's inception, a pure minority court protects that understanding as a "reasonable expectation" regardless of the circumstances before the court.²²⁹ A minority shareholder's misconduct or incompetence in his job, for example, is seemingly ignored once a basic understanding of employment is proven.²³⁰ By not considering what the parties would have likely understood if they had bargained over these circumstances, the pure minority perspective overemphasizes minority rights and wrongfully excludes any consideration of majority concerns.

The modified majority perspective has the potential to conform to the understandings from the hypothetical bargains, but only if the less harmful alternative language is interpreted to place minority interests reasonably ahead of corporate interests.²³¹ The "reasonably ahead" notion is needed in order to prevent the modified majority perspective from overprotecting the minority's interests in situations of minority misconduct or incompetence.²³² If the less harmful alternative restriction is construed to place minority interests ahead of corporate interests except when the minority's own fault is at issue, the modified majority perspective will conform to the understandings from the hypothetical bargains.²³³ Indeed, when construed in this manner, majority actions benefiting the corporation will still trigger oppression liability as long as the minority's interests are harmed through no fault of its own.

The courts, however, are unlikely to attach such a pro-minority construction to the less harmful alternative language. The background of the *Wilkes* decision, for example, suggests that the less harmful alternative language was not intended to signify a pro-minority position.²³⁴ In *Wilkes*, the factual circumstances at issue demonstrated a clear freeze-out. *Wilkes*' salary was terminated, he was voted out as an officer and director, and he received no dividend payments from the corporation.²³⁵ Moreover, the majority had no justification for its actions.²³⁶ Simply put, the majority's conduct was far from borderline—its conduct was classically oppressive and there was no question that

229. See *supra* text accompanying notes 92-93.

230. See, e.g., *Topper*, 433 N.Y.S.2d at 362; *Balvik v. Sylvester*, 411 N.W.2d 383, 388 (N.D. 1987); *supra* notes 91-93 and accompanying text.

231. See *supra* Part IV.A. (discussing the modified majority perspective).

232. See *supra* text accompanying notes 130-34.

233. Moreover, with this construction, the modified majority perspective will function identically to the modified minority perspective.

234. See *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657, 658-61 (Mass. 1976).

235. See *id.* at 658, 662 n.13.

236. See *id.* at 663.

the majority had abused its business discretion. On the facts of *Wilkes*, therefore, it is curious why the Supreme Judicial Court of Massachusetts felt the need to soften the minority-friendly *Donahue* duty with the more majority-friendly legitimate business purpose inquiry. One plausible explanation is that the court was gravely concerned that its *Donahue* duty and accompanying equal opportunity rule were too destructive of majority prerogatives.²³⁷ Consequently, the court pounced on its first opportunity to soften the standard, despite the egregiousness of the majority's conduct in the particular case.²³⁸ To the extent that this explanation is valid, it suggests that the *Wilkes* legitimate business purpose inquiry was intended to provide the majority with greater flexibility to make decisions.²³⁹ Construing the less harmful alternative language to place minority interests over corporate interests would undercut this intentional effort to favor the majority and is, therefore, an unlikely construction.²⁴⁰ It is much more plausible to assume that the *Wilkes* court intended the less harmful alternative language to protect the minority shareholder only when the minority can propose an alternative course of action that is comparable to the majority's conduct in terms of corporate expense and feasibility. The *Wilkes* court arguably suggested as much by noting that the legitimate business purpose must be weighed against the "practicability" of a less harmful alternative.²⁴¹ Of course, if a modified majority court favors corporate interests over minority interests, the modified majority perspective does not conform to the understandings

237. See *supra* text accompanying notes 54-55.

238. See, e.g., Cox, *supra* note 144, at 632 (noting that the *Wilkes* court "retreat[ed] from the broad equal opportunity mandate it embraced earlier in *Donahue*").

239. Indeed, significant passages in the *Wilkes* opinion focus entirely on the need to preserve the majority's decision-making discretion. See, e.g., *supra* text accompanying note 68.

240. Cf. Peeples, *supra* note 69, at 500 ("The tone of the *Wilkes* opinion suggests that a court comparing alternative means should respect the decisions of those in control. The *Wilkes* court deemed a 'large measure of discretion' appropriate." (quoting *Wilkes*, 353 N.E.2d at 663)).

Courts outside of Massachusetts, of course, may have different views. Many of these courts, however, adopted the "less harmful" alternative language from the *Wilkes* court. See, e.g., *Solomon v. Atlantis Dev., Inc.*, 516 A.2d 132, 136 (Vt. 1986). Thus, the intent of the Supreme Judicial Court of Massachusetts in adopting the less harmful alternative language may have a significant influence on courts in other jurisdictions.

241. *Wilkes*, 353 N.E.2d at 663; see also *Zimmerman v. Bogoff*, 524 N.E.2d 849, 853 (Mass. 1988) (noting that liability for breach of the *Donahue* duty will result "unless the wronged shareholder succeeds in showing that the proffered legitimate objective could have been achieved through a less harmful, *reasonably practicable*, alternative mode of action" (emphasis added)); *supra* note 107.

from the hypothetical bargains. As a consequence, it is not the perspective from which shareholder oppression should be viewed.²⁴²

The modified minority perspective, however, includes the necessary flexibility that is required to enforce the understandings from the hypothetical bargains. By making a further inquiry into whether a basic understanding was intended to continue in the circumstances,²⁴³ the modified minority perspective allows a court to apply the hypothetical bargain understandings as the presumptive understandings of the parties that were intended to govern the circumstances at issue.²⁴⁴ From a modified minority perspective, therefore, a reasonable expectation exists not simply when the majority lacks a legitimate business purpose for its actions; instead, a reasonable expectation typically exists when it is consistent with the hypothetical bargain understandings. Because the modified minority perspective is flexible enough to incorporate these understandings, such a perspective should be viewed as the preferable framework for the shareholder oppression analysis.

E. The Proper Operation of the Modified Minority Perspective

When viewing oppression from a modified minority perspective, it is critical to recall that the inquiry into reasonable expectations consists of two steps. First, courts have noted that reasonable expectations are based on understandings shared by all of the investors at the inception of a business.²⁴⁵ Thus, when a complaining shareholder as-

242. See Cox, *supra* note 144, at 635 (noting that "the more enabling standard of a business purpose justification for unequal treatment . . . give[s] insufficient attention to the owners' probable intent").

243. See *supra* notes 120-22 and accompanying text.

244. See *infra* Part V.E.

245. See, e.g., Gimpel v. Bolstein, 477 N.Y.S.2d 1014, 1019 (Sup. Ct. 1984) ("[T]he 'reasonable expectations' test is indeed an examination into the spoken and unspoken understanding upon which the founders relied when entering into the venture."); Robblee v. Robblee, 841 P.2d 1289, 1293 (Wash. Ct. App. 1992) ("'Reasonable expectations' are those spoken and unspoken understandings on which the founders of a venture rely when commencing the venture."); see also *In re Kemp & Beatley, Inc.*, 473 N.E.2d 1173, 1179 (N.Y. 1984) ("A court considering a petition alleging oppressive conduct must investigate what the majority shareholders knew, or should have known, to be the petitioner's expectations in entering the particular enterprise."); *id.* (noting that unfulfilled "subjective hopes and desires in joining the venture" are insufficient to establish an oppression claim) emphasis added); Meiselman v. Meiselman, 307 S.E.2d 551, 563 (N.C. 1983) ("Privately held expectations which are not made known to the other participants are not 'reasonable.'"); Bahls, *supra* note 14, at 322-23 n.229 ("[C]ourts have been careful to protect only those expectations of the minority known by and acquiesced to by the majority."); Hillman, *supra* note 27, at 78 ("[O]nly expectations embodied in understandings, express or implied, among the participants should be recognized."); Robert W. Hillman, *Indissoluble Partnerships*, 37 U. FLA. L. REV. 691, 728 (1985) (noting that relief may be warranted "[t]o the extent that a minority shareholder had reasonable expectations at the inception of a venture, those expecta-

serts that his reasonable expectation of employment or management participation has been frustrated by majority conduct, a court must first satisfy itself that all of the investors shared a basic understanding of employment or management participation at the outset of the venture. More precisely, the aggrieved shareholder must offer evidence indicating that the stockholders shared a basic understanding at the venture's inception of an entitlement to certain specific benefits (e.g., employment, management participation) due to their commitments of capital to the business.²⁴⁶ Second, a court must satisfy itself that all of the investors intended such a basic understanding to persist in the post-inception circumstances before the court.²⁴⁷ The alleged frustrated expectations of an aggrieved shareholder are deemed "reasonable" and worthy of protection only after both steps are accomplished.

With regard to the first step, the existence of basic understandings between the shareholders will occasionally be explicit, particularly where written documents exist that spell out those understandings.²⁴⁸ Because close corporations often operate on a more informal basis, however, such memorialized evidence is rare.²⁴⁹ Thus,

tions were understood by other participants in the enterprise, and the prospect that the expectations will be realized is remote"); Thompson, *supra* note 37, at 224 (observing that a reasonable expectations standard is based "on the parties' understandings"); *supra* notes 61, 69-71 and accompanying text.

246. See Moll, *supra* note 29, at 552 ("An inquiry into what the shareholder reasonably expected his investment entitled him to should be seen as an attempt to link the commitment of capital to certain expected benefits such that the benefits can be characterized as components of the investment."); *id.* ("For example, an inquiry into whether a shareholder reasonably expected continued employment should be understood as an inquiry into whether the shareholder reasonably expected that her investment in the venture entitled her to continued employment with the close corporation.").

247. See *supra* text accompanying note 120.

248. See, e.g., *In re Topper*, 433 N.Y.S.2d 359, 366 (Sup. Ct. 1980) ("The Court may determine the understanding of the parties as to the role the complaining shareholder is expected to play from agreements and evidence submitted."); Hillman, *supra* note 27, at 78 ("The clearest type of expectation is one which is set forth in a shareholder's agreement signed by all of the parties."); cf. MINN. STAT. ANN. § 302A.751(3a) (West 1992) ("[A]ny written agreements, including employment agreements and buy-sell agreements, between or among shareholders or between or among one or more shareholders and the corporation are presumed to reflect the parties' reasonable expectations concerning matters dealt with in the agreements.").

249. See, e.g., Chittur, *supra* note 204, at 160 (noting that the expectations of a close corporation shareholder "may not be articulated with lawyerly precision"); O'Neal, *supra* note 75, at 883-84 ("A person taking a minority position in a close corporation often leaves himself vulnerable to squeeze-out or oppression by failing to insist upon a shareholders' agreement or appropriate charter or bylaw provisions . . ."); *id.* at 886 ("The participants typically enter into 'agreements' among themselves, which sometimes are reduced to writing in the form of a formal preincorporation agreement or a shareholders' agreement, but which often are oral, perhaps just vague and half-articulated understandings"); see also *Exadaktilos v. Cinnaminson Realty Co.*, 400 A.2d 554, 561 (N.J. Super. Ct. Law Div. 1979), *aff'd*, 414 A.2d 994 (N.J. Super. Ct. App. Div. 1980)

aggrieved shareholders typically rely on circumstantial evidence drawn from the parties' actions and course of conduct to establish the basic understandings shared by the investors at the outset of the business.²⁵⁰ Because circumstantial evidence suffices to establish these

(noting that "[t]he expectations of the parties in the instant suit with regard to their participation in corporate affairs are not established by any agreement"); Chittur, *supra* note 204, at 131 (observing that "people generally avoid complex and expensive planning in small businesses"); *id.* at 139 (stating that "inadequately planned close corporations will always remain part of the picture," and noting that "[t]he most careful plan may fail to visualize some conflicts, even if it does not generate novel ones of its own").

250. See, e.g., *Topper*, 433 N.Y.S.2d at 365 ("The parties' full understanding may not even be in writing but may have to be construed from their actions."); Thompson, *supra* note 37, at 217 ("Expectations . . . must be gleaned from the parties' actions as well as their written documents."); cf. *Exadaktilos*, 400 A.2d at 561 (noting that "[t]he expectations of the parties in the instant suit with regard to their participation in corporate affairs are not established by any agreement; they must be gleaned from the evidence presented").

For example, assume that all of the shareholders in a close corporation invest a substantial sum of capital in the business, quit their prior employment, and begin working for the close corporation. The company pays no dividends and distributes all of its profits as salary to the shareholders. Even without an explicit agreement, it is a fair inference that all of the shareholders implicitly understood that their investment entitled them to continued employment with the company. Indeed, because the shareholders left their prior employment positions, they all likely understood that the close corporation jobs would become their primary (if not sole) sources of livelihood. See *supra* notes 221-23 and accompanying text. Moreover, because of the absence of dividends, they all likely understood that a job with the corporation and its accompanying salary would be the only vehicles for distributing the returns of the business. See *supra* notes 44, 197 and accompanying text. Thus, the parties' own actions suggest a shared, implicit understanding that investment in the business entitled a shareholder to continued employment with the company. Cf. *Muellerberg v. Bikon Corp.*, 669 A.2d 1382, 1388 (N.J. 1996) ("In this case, it is reasonable to conclude that Burg's fair expectations were that should he give up his prior employment with a competitor company and enter this small corporation, he would enjoy an important position in the management affairs of the corporation."); *In re Gunzberg v. Art-Lloyd Metal Prods. Corp.*, 492 N.Y.S.2d 83, 85 (App. Div. 1985) ("As a result of their long history of taking an active part in the running of the corporation, petitioners demonstrated that they had a reasonable expectation that they would continue to be employed by the company, and have input into its management."); *Balvik v. Sylvester*, 411 N.W.2d 383, 388 (N.D. 1987) ("Balvik quit his former job to join Sylvester in the new business enterprise, making a relatively substantial investment in the process. It is apparent from the record that Balvik's involvement with [the business] constituted his primary, if not sole, source of livelihood and that he quite reasonably expected to be actively involved in the operation of the business."); see also Hillman, *supra* note 27, at 78 ("That assumptions are not made explicit does not require that they be disregarded when they are accepted or assumed by the other participants.").

Of course, the direct testimony of the parties can also serve as evidence of an understanding between the shareholders. In *Wilkes*, for example, the court noted that "[a]t the time of incorporation it was understood by all of the parties that each would be a director of [the close corporation] and each would participate actively in the management and decision making involved in operating the corporation." *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657, 659-60 (Mass. 1976). As evidence of this understanding, the *Wilkes* court recounted the following testimony of two of the company's shareholders:

Wilkes testified before the master that, when the corporate officers were elected, all four men "were . . . guaranteed directorships." Riche's understanding of the parties' intentions was that they all wanted to play a part in the management of the corporation and wanted to have some "say" in the risks involved; that, to this end, they would all be directors; and

basic understandings, the first step in the modified minority inquiry is a minimal hurdle that typically poses little difficulty for a complaining shareholder. Significantly, however, if an aggrieved shareholder is unable to establish a basic understanding relevant to his claim (e.g., a shared understanding of employment), the first step in the inquiry is not accomplished, and the shareholder's alleged frustrated expectation should not be considered reasonable or enforceable.²⁵¹

At the second step of the analysis, there is generally no evidence indicating whether the parties intended a basic understanding to continue in the post-inception circumstances before the court. For example, a minority shareholder may offer evidence indicating that all of the shareholders are founders who have continuously worked for the company since its formation. Such proof may suffice to establish that, at the venture's inception, a basic understanding was reached that all shareholders were entitled to employment as a result of their

that "unless you (were) a director and officer you could not participate in the decisions of (the) enterprise."

Id. at 660 n.7.

251. In some situations, the circumstantial or other evidence will not suggest a mutual understanding at the venture's inception that investment in the company entitled a shareholder to employment or other specific corporate benefit. *See Merola v. Exergen Corp.*, 648 N.E.2d 1301, 1304 (Mass. App. Ct. 1995) (noting the need to establish a "nexus between a plaintiff's investment of capital and his employment in the corporation" before a shareholder can challenge the denial of employment in an oppression claim). To use employment as an example, a close corporation may have numerous shareholders without employment positions or may have no general policy regarding stock ownership and employment. *See, e.g., Merola v. Exergen Corp.*, 668 N.E.2d 351, 354-55 (Mass. 1996) (refusing to find that a termination of a shareholder-employee was a breach of fiduciary duty in part because "[t]here was no general policy regarding stock ownership and employment, and there was no evidence that any other stockholders had expectations of continuing employment because they purchased stock"). Alternatively, the language of an express shareholder's agreement may negate any inference of a mutual understanding that the commitment of capital entitled an investor to employment. *See, e.g., In re Apple*, 637 N.Y.S.2d 534, 535 (App. Div. 1996) (noting that a buyout agreement explicitly bound each shareholder to sell "after ceasing for any reason, either voluntarily or involuntarily, to be in the employ of the corporation," and stating that the terminated shareholder-employee "cannot be heard to argue that he had a reasonable expectation that he would be employed and would be a shareholder for life"); *Ingle v. Glamore Motor Sales, Inc.*, 528 N.Y.S.2d 602, 604 (App. Div. 1988) ("The plaintiff was aware throughout his employment of the possibility that he could be discharged at the will of the defendants since he repeatedly signed agreements which provided for his discharge 'for any reason' and for the repurchase of his interest in the corporation at that time."). In these circumstances, there is no evidence of a mutual understanding that a shareholder is entitled to continued employment with the company because of his investment. When an aggrieved shareholder challenges his denial of employment, therefore, a court should not find that a basic understanding of employment has been established. Indeed, a court should conclude that the alleged frustrated expectation of employment is unreasonable and unenforceable. *See also Mitchell, supra* note 71, at 1707 ("[I]t cannot *always* be a breach of fiduciary duty, even in a close corporation, to refuse or cease to employ a particular shareholder in the business."); *Moll, supra* note 29, at 559-61 (noting that not all close corporation shareholders reasonably expect that their investment entitles them to employment).

investments.²⁵² The first step in establishing a reasonable expectation of employment would therefore be met.

Is this basic understanding of employment, however, still shared by the parties *after* the venture's inception when the minority shareholder has engaged in misconduct, or when the minority shareholder's performance is inadequate, or when the minority shareholder can be replaced by a more efficient and less costly machine? Even after a basic understanding at the outset of the business has been established, a modified minority court must take the second step before it can conclude that a reasonable expectation has arisen. The modified minority court must inquire into whether the investors intended their basic understanding to persist in the post-inception circumstances at issue.

It is at this second step where the understandings from the hypothetical bargains should be incorporated into the oppression analysis. As mentioned, the understandings should serve as the presumptive terms of the deal between the shareholders. When employment is at issue, for example, the understandings from the hypothetical bargains should create a rebuttable presumption that the investors intended for the basic understanding of employment to persist in the absence of shareholder misconduct or incompetence.²⁵³ Thus, if the majority attempts to justify the termination of a minority shareholder's employment on other legitimate business grounds, such as the existence of a more productive machine or the need for professional management, the modified minority court should reject such justifications. Instead, the court should enforce the basic understanding of employment as a continuing understanding of employment in the circumstances—i.e., as a “reasonable expectation” of employment in the circumstances.²⁵⁴

It bears repeating, however, that *rebuttable* presumptions are created by the hypothetical bargain understandings. If there is evidence indicating that the parties reached a consensus contrary to these understandings, that consensus should control as the actual understanding of the parties that was intended to govern the particular circumstances before the court. For example, an express shareholder's agreement may give the majority shareholder the right to

252. See *supra* note 250 and accompanying text.

253. Cf. Miller, *supra* note 98, at 263 (noting that “[t]o provide some guidance to shareholders, a series of acts should be presumed to indicate the existence of oppressive conduct,” and including “the restriction or preclusion of employment” as presumptively oppressive conduct).

254. See *supra* notes 214-23 and accompanying text. As mentioned, the minority shareholder must first prove that the investors shared a basic understanding of employment at the venture's inception before the second step and the rebuttable presumptions are reached.

terminate the employment of a minority shareholder for "any reason" or for "legitimate business reasons."²⁵⁵ A contractual provision reflecting any of these terms would rebut at least one of the understandings resulting from the hypothetical bargains.²⁵⁵ The provision should, therefore, be enforced as the actual understanding of the parties. In many cases, however, the parties will not have discussed the particular circumstances before the court. Thus, they will not have reached a consensus on whether a basic understanding was intended to continue in those circumstances.²⁵⁷ In these "unforeseen" situations, a court should apply the presumptions created by the hypothetical bargain understandings.

Properly understood, therefore, a modified minority perspective entails a two-step inquiry into reasonable expectations. A shareholder challenging the denial of specific benefits (e.g., employment, management participation) must first offer proof to establish that the investors shared a basic understanding at the venture's inception of an entitlement to the denied benefits.²⁵⁸ If the shareholder overcomes this hurdle, the modified minority court must then determine if the investors intended the basic understanding to persist in the post-inception circumstances before the court. To answer this question, a court should apply the understandings from the hypothetical bargains as rebuttable presumptions that will decide the case in the absence of contrary evidence. If both steps are satisfied, the court should deem

255. See, e.g., *Jenkins v. Haworth, Inc.*, 572 F. Supp. 591, 595 (W.D. Mich. 1983) (involving a mandatory buyout when an employee "shall be terminated for any reason," including "involuntary events"); *Gallagher v. Lambert*, 549 N.E.2d 136, 136 (N.Y. 1989) (involving a mandatory buy-back provision upon "voluntary resignation or other termination"); see also *supra* note 251.

256. For example, a shareholder's agreement allowing the majority shareholder to terminate the employment of a minority shareholder for "any reason" or for "legitimate business reasons" works in a pro-majority fashion by countering the hypothetical bargain understandings that a shareholder can be terminated for misconduct or incompetence but not for any legitimate business purpose. See *supra* notes 211-23 and accompanying text.

Depending on the language of the particular shareholder's agreement, the agreement may affect both steps of the modified minority inquiry. At the first step, for example, an agreement stating that a minority shareholder can be terminated for "any reason" probably negates any inference of a mutual understanding that the commitment of capital entitled an investor to employment. See *supra* note 251 and accompanying text. Although the second step would not be reached, the same language would rebut the second-step presumption that the investors intended for a basic understanding of employment to persist in the absence of shareholder misconduct or incompetence.

257. Cf. O'Neal, *supra* note 75, at 886 (noting that close corporation shareholders have often reached "just vague and half-articulated understandings").

258. The aggrieved shareholder has the burden of proof at this first step. See Thompson, *supra* note 37, at 217 ("Courts permit expectations to be established outside of formal written agreements, but the minority shareholder retains the burden of proving the existence of the expectations."); *supra* note 251 and accompanying text.

the frustrated expectation "reasonable" and should grant oppression relief.

Ideally, this discussion of the proper operation of the modified minority perspective will assist courts in their oppression analyses. The discussion explicitly indicates, for example, that the initial step of the modified minority inquiry requires evidence. Indeed, the minority shareholder must offer minimal evidence, but evidence nonetheless, to establish a basic understanding between the shareholders regarding an entitlement to specific corporate benefits. Properly understood, therefore, the initial step of the inquiry corrects the erroneous suggestion of some courts that the oppression doctrine is automatically invoked whenever a shareholder is denied a corporate benefit.²⁵⁹ In addition, and perhaps more importantly, this discussion explicitly indicates that the second step of the modified minority inquiry does not require evidence. Indeed, this Article is the first to propose that rebuttable presumptions stemming from the hypothetical bargains should be used in the analysis.²⁶⁰ At this second step, therefore, courts should understand that evidence is required only if a party wishes to rebut the operative presumptions.

Aside from providing direction to courts, this discussion of the proper operation of the modified minority perspective clarifies the rights of both minority and majority shareholders. Aggrieved minority shareholders should understand that, after they establish a basic understanding shared by the investors at the venture's inception, the law will use presumptions to protect the shareholders' expectations without any further proof. Similarly, when majority shareholders make certain decisions (e.g., termination decisions), they should understand that contractual or other evidence will be necessary to rebut the presumptions and to avoid liability.²⁶¹ Moreover, when employment is at issue, this Article explicitly defines the operative presumptions. Thus, minority shareholders will know when they can successfully challenge their terminations as oppressive. Correspondingly, majority shareholders will know when they can terminate a minority shareholder without invoking oppression liability.²⁶² In this manner, the

259. See Moll, *supra* note 29, at 559-62.

260. See *supra* text accompanying notes 253-57.

261. In theory, there may be instances where the *minority* shareholder will need to rebut a presumption created by the hypothetical bargains. For example, if the minority wants to eliminate the majority's discretion to terminate for misconduct or incompetence, the minority will need proof to rebut the presumption that termination on these grounds is proper. See *supra* notes 211-13 and accompanying text.

262. See Gerard P. Tishler & Jennifer R. Searle, *Merola v. Exergen Corporation: Lawful Termination of a Minority Shareholder's Employment (Absent a Legitimate Business Purpose)*, 41 BOSTON B.J. 6, 7 (Jan. 1997) (observing that judicial decisions "have offered little in the way of

modified minority perspective, as explained by this Article, fosters more informed investment decisions by minority shareholders as well as more informed business decisions by majority shareholders.

Even if a modified minority perspective is not adopted, this Article has provided a broader discussion of the distinctions between the perspectives. At the very least, therefore, this broader discussion should assist courts in evaluating the various oppression definitions and approaches. Similarly, such a discussion should give litigants a better sense of their rights in a particular jurisdiction.

F. The Implications of the Modified Minority Perspective

1. Liability for Profitable Corporate Action

At first glance, incorporating the understandings from the hypothetical bargains into a modified minority oppression analysis appears to have striking implications. After all, if a modified minority court presumptively enforced these understandings in its reasonable expectations inquiry, the majority shareholder would be prohibited from taking certain actions that are undeniably in the corporation's interest. Put more strongly, the shareholder oppression doctrine would compel a close corporation to be less profitable in certain situations.²⁶³

When the typical shareholder's rationale for investing in a close corporation is considered, however, this implication is much more palatable. Indeed, maximizing the profitability of the corporation should not be understood as the sole (or even primary) basis for the investment of the typical close corporation shareholder. As mentioned, corporate profitability is only one component of the typical close corporation shareholder's investment—a component that is often of less importance than the employment aspect of the investment.²⁶⁴ The critical point to add, however, is that acceptance of the understandings from the hypothetical bargains necessarily implies that the majority shareholder has assented to limitations on her ability to make

operational direction for applying [oppression] principles to either minority shareholders who find themselves discharged from employment or majority shareholders who announce their terminations"); see also Thompson, *supra* note 37, at 224 (noting that a judicial role would not be attractive "if the possibility of later judicial interference itself created uncertainties").

263. It should be noted that public corporations are, to some extent, permitted to act in ways that are not designed (at least directly) to increase profits. See, e.g., DEL. CODE ANN. tit. 8, § 122(9) (1991) (allowing corporations to "[m]ake donations for the public welfare or for charitable, scientific or educational purposes"); 15 PA. CONS. STAT. § 1502(a)(14) (1999) (allowing corporations to grant "allowances or pensions" to the dependents of deceased directors, officers, and employees).

264. See *supra* notes 189-92 and accompanying text.

profit-maximizing decisions. If one accepts these understandings, in other words, one necessarily accepts that the majority shareholder has agreed to limitations on her power.²⁶⁵ Indeed, the understandings represent the product of compromises entered into by the majority shareholder at the outset of the business in order to induce the minority shareholders to commit their capital to the venture.²⁶⁶ The understandings are "terms," therefore, that set the ground rules for the operation of the company.

Viewed in this manner, the shareholder oppression doctrine is merely enforcing the terms of the deal as understood by all parties at the inception of the enterprise. In other words, the understandings from the hypothetical bargains convey that, from the outset, *all* of the shareholders presumptively understood (1) that corporate profitability was only one component of the investment "deal," and (2) that corporate profitability could not necessarily be pursued at the expense of the other investment components. Thus, when the majority shareholder subsequently asserts that enhancing corporate profits justifies harming other aspects of the minority's investment, the majority's conduct should be viewed as an impermissible attempt to change the terms of the deal that she knowingly accepted and that she knew the minority shareholders had relied on in deciding to commit their capital to the business.²⁶⁷

Further, it is worth noting that the majority shareholder likely *agrees* with these terms that she has knowingly accepted. Indeed, at the outset of the venture, attaching primary importance to the "individual" investment components (e.g., employment, management participation) rather than to the "enterprise" investment component (e.g., corporate profitability) is normally consistent with the majority's interests as well. After all, the typical majority shareholder has often left prior employment herself to join the speculative start-up business.²⁶⁸ Of course, it is hard to imagine the majority shareholder

265. These "limitations" are imposed on matters that affect the shareholders' individual rights and not on general matters relating to the conduct of the corporation's business. See *infra* note 280 and accompanying text.

266. See *supra* text accompanying notes 210, 218.

267. In this context, the majority shareholder should be viewed as simply appropriating a portion of the minority's investment to further the majority's own interests. See, e.g., O'Neal, *supra* note 75, at 887 ("Not to provide a remedy in circumstances of this kind is to permit the majority shareholders to exploit the minority shareholder's investment solely for their own benefit."); Prentice, *supra* note 90, at 134 (same).

268. See, e.g., *Harris v. Mardan Bus. Sys., Inc.*, 421 N.W.2d 350, 352 (Minn. Ct. App. 1988) (involving a close corporation majority shareholder who left prior employment with a large public company to form the close corporation); see also 1 O'NEAL, OPPRESSION, *supra* note 14, § 1:03, at 4 ("Quite commonly when a participant invests in a close corporation he expects to work in the business on a full-time basis.").

firing herself to benefit the corporation. In some sense, therefore, the modified minority perspective is simply conveying that the majority cannot do to the minority what it would not do to itself.²⁶⁹

Thus, although the shareholder oppression doctrine does compel a close corporation to be less profitable in certain situations, such a result is appropriate because it conforms with the understandings presumptively reached by the minority *and majority* investors.²⁷⁰ Moreover, such a result is fair because the majority knew that these understandings were relied on by the minority stockholders in committing their capital to the business.²⁷¹ Finally, such a result is necessary because it preserves a critical source of start-up capital for future ventures. Given that investors commit their capital to close corporations in reliance on the "terms" represented by the understandings from the hypothetical bargains, the law's refusal to enforce those terms would presumably diminish available capital over time and prevent some close corporations from forming.²⁷² Thus, enforcing the

269. This version of the "golden rule" could also support a pure minority perspective. After all, it is hard to imagine the majority shareholder firing herself for any reason, including her own misconduct or incompetence. If the majority shareholder is unwilling to enforce the terms of the hypothetical bargains against herself, it seems perfectly appropriate for the law to prohibit the majority from selectively applying the bargains against the minority. Put differently, if the majority shareholder can maintain her job even when majority misconduct or incompetence is present, perhaps the minority shareholder should have the same "right" to continued employment even when minority misconduct or incompetence is present.

270. See Bradley, *supra* note 101, at 840 ("The majority shareholders understand that the minority shareholders have not entered the venture knowingly taking the investment risk that they may have to suffer the deprivation of any meaningful governance input or share in economic return because they have submitted to the exercise of an undiluted and untempered majority power short of fraud, misappropriations or breach of fiduciary duty.").

271. Indeed, the understandings from the hypothetical bargains suggest that the minority shareholders would have refused to invest in the business if these understandings had not been reached. See *supra* text accompanying notes 210, 218.

272. As commentators have observed:

[A] potential source of much-needed risk capital for small business enterprises is threatened by the prevalence of squeeze-outs. Most small businesses depend largely upon individuals in the local community for risk capital. Certainly the frequency of squeeze-outs and the dire consequences to the squeezees have become well-known to many prospective investors. Undoubtedly, some persons, because of the dangers of oppression in a close corporation, choose to purchase securities in public-issue corporations or even permit their accumulated funds to remain idle rather than risk the purchase of a minority interest in a closely held enterprise.

Most small businesses cannot enter national credit markets. . . . As the sources of equity capital open to large corporations are not available to small businesses, it is all the more important that investment in small businesses be made attractive to local investors and that they be given full assurance that they will receive just treatment at the hands of their fellow participants.

1 O'NEAL, OPPRESSION, *supra* note 14, § 1:04, at 8.

Businesses may still commence, of course, in a non-corporate form. Indeed, to the extent that investors fear the possibility of a freeze-out, the business could simply commence as a partner-

understandings from the hypothetical bargains may result in an economic benefit that outweighs any drag on corporate profitability.²⁷³

2. Liability for "Legal" Majority Conduct

A related implication stems from incorporating the hypothetical bargain understandings into the modified minority oppression analysis. Some of the majority's actions will trigger oppression liability even though the actions are permissible under the state's corporation statute, the company's charter, and the company's bylaws. Despite the seeming "legality" of these majority actions, however, close corporation shareholders should not be viewed as consenting to the default norm of majority rule and the default assumption that company benefit equals shareholder benefit.²⁷⁴ Indeed, acceptance of the hypothetical bargain understandings necessarily implies that the shareholders entered into a presumptive arrangement regarding the operation of the business that was intended to *supplant* the corresponding legal norms.²⁷⁵ Put differently, although the majority conduct is facially "proper" when measured against the statutes and bylaws, the modified minority perspective recognizes that the conduct may actually be "improper" to the extent that it breaches the shareholders' presumptive understandings regarding the operation of their business.²⁷⁶ Characterizing the shareholder oppression doctrine as a pun-

ship or other non-corporate structure that presents little, if any, danger of a freeze-out. *See, e.g.*, UNIF. PARTNERSHIP ACT §§ 31(1)(b), 31(2), 38 (permitting the dissolution of a partnership by the express will of any partner, and allowing the partner to recover the amount of his partnership interest upon dissolution).

273. *See* Hetherington & Dooley, *supra* note 1, at 50 (noting that limiting the majority shareholder's ability to freeze-out the minority shareholder "may well facilitate equity investments in close corporations").

274. *See* Bradley, *supra* note 101, at 840 ("Minority shareholders should not be understood as having agreed that the venture is to be operated strictly as a majority-rule entity with the economic chips falling as they may.").

275. *Cf.* CARY & EISENBERG, *supra* note 33, at 402 (stating that "enabling" schemes "serve[] principally to validate specific types of arrangements the parties may make"); JAMES D. COX, THOMAS LEE HAZEN, & F. HODGE O'NEAL, *CORPORATIONS* 33 (1997) (noting that "[m]odern business corporation statutes are primarily 'enabling' acts").

276. As one commentator observed:

It is no answer to say that majority shareholders are simply exercising powers and rights that the corporation act and the corporation's charter and bylaws give them, or that when a shareholder enters into a corporation he "contracts" with his fellow shareholders against the background of the act, charter and bylaws, and that those instruments become part of the contract. A "contract" among shareholders in a close corporation which is based entirely on the corporation act and the corporation's charter and bylaws and gives no effect to the understandings and assumptions of the parties may be so one-sided, in that holders of a majority of the corporation's shares can at their whim deprive a minority shareholder of any participation in the business or of any return on his investment (akin to taking his property without any compensation and without due process of law),

isher of "legal" majority conduct is, therefore, misleading. In actuality, the doctrine functions as an enforcer of mutual and relied-upon understandings²⁷⁷ that were intended to displace the related provisions of the formal bylaws and statutory norms.²⁷⁸

that a court would be fully justified in refusing to enforce the contract on the ground that it is "unconscionable."

O'Neal, *supra* note 75, at 888; see *In re Topper*, 433 N.Y.S.2d 359, 365 (Sup. Ct. 1980) ("This Court . . . recognizes that in a close corporation the bargain of the participants is often not reflected in the corporation's charter, by-laws nor even in separate signed agreements."); O'Neal, *supra* note 75, at 886 ("In a close corporation, the corporation's charter and bylaws almost never reflect the full business bargain of the participants."); *id.* at 887 ("[Acts] which, in law, are a valid exercise of powers conferred by the articles may nevertheless be entirely outside what can fairly be regarded as having been in the contemplation of the parties when they became members of the company." (internal quotation omitted)); *id.* ("[E]ven when there has been nothing done in excess of power it is necessary to consider whether the situation which has arisen is not quite outside what the parties contemplated . . . and whether what has been done is not contrary to the assumptions which were the foundation of their agreement."); Prentice, *supra* note 90, at 134 (finding unsatisfactory the argument "that the minority shareholder has no one to fault but himself in that his exclusion from participation in the management of the company is merely a consequence of the contract between himself and the company established by the articles of association, a contract which putatively he has freely entered into," and noting that "[i]n establishing the nature of the relationship between the members of a private company, it is necessary for the courts to go beyond the provisions in the articles of association and in addition to take into consideration the expectations of the parties when the company was originally formed" (footnote omitted)); see also Chittur, *supra* note 204, at 159 (stating that "[t]he public corporation can be viewed as a standard form multiparty contract, some of the terms of which are specified by statute," and noting that "[t]he close corporation does not involve the same 'standard form' contract, or the consequential grant of power"); Prentice, *supra* note 90, at 146 ("Where [expectations] have been interfered with or are in some way unfulfilled, then this should prima facie constitute oppression whether or not there was any legal impropriety.").

277. Aside from enforcing these mutual understandings, it is critical to note that the shareholder oppression doctrine gives them legal significance. Indeed, if mutual "understandings" rose to the level of "agreements," the law of contracts could enforce them and the shareholder oppression doctrine would presumably be unnecessary. At some level, therefore, the development of the oppression doctrine is evidence that these "understandings" do fall short of established contracts and that some other legal theory is needed to protect them. Without the shareholder oppression doctrine, in other words, these "understandings" are legally insignificant. With the shareholder oppression doctrine, however, these "understandings" become legally-protected interests.

278. If the majority shareholder has acted in furtherance of a legitimate business purpose and without any improper freeze-out considerations, the relief granted to the minority shareholder could be structured to account for this lack of "majority fault." See, e.g., N.J. STAT. ANN. § 14A:12-7 (West Supp. 1999) (stating that the court may award fair value "plus or minus any adjustment deemed equitable by the court"); Hillman, *supra* note 27, at 76 ("If the matter is approached as independent of the issue of misconduct, relief may be tailored to reflect the absence of wrongful conduct by those in control of the venture."). Perhaps adjustments in the technique utilized to value the minority's holdings could be made. See, e.g., *Id.* at 82 (noting that "the highest valuation might be achieved by utilizing an earnings-based method," and indicating that "the use of a method based upon the liquidation value of corporate assets . . . can be expected to result in a lower figure than other approaches"). But see Moll, *supra* note 29, at 568-80 (explaining that a conventional earnings-based buyout already fails to compensate the oppressed shareholder for the employment and management aspects of his investment). Perhaps some combination of minority and marketability discounts could be employed to reduce the amount

3. Limited Majority Discretion

As the last two sections have illustrated, the modified minority perspective limits the majority shareholder's discretion to act in furtherance of the corporation's interests. Indeed, majority actions that further a legitimate business purpose may still give rise to liability under a modified minority oppression analysis. As mentioned, when the understandings from the hypothetical bargains are considered, this limited discretion is appropriate.²⁷⁹

More importantly, however, this limited discretion is not as restrictive as it may seem. First, the majority's discretion is only limited for decisions that impact the rights of individual shareholders. For more general decisions, such as the choice of one business opportunity over another, the modified minority perspective would not limit the majority's prerogatives.²⁸⁰ Second, because the understandings from the hypothetical bargains create rebuttable presumptions, the majority shareholder can always insure that she will have discretion to act in the corporation's interest by explicitly setting forth that discretion in a contract with the minority shareholders.²⁸¹ Finally, the majority's discretion will not be limited at all if the majority (or the corporation) is willing to buy out the holdings of the oppressed minority shareholder.²⁸² For these reasons, the adoption of the modified minority

owed to the minority shareholder. See, e.g., 2 O'NEAL, OPPRESSION, *supra* note 14, § 7.15, at 115-16; Bahls, *supra* note 14, at 301-04. Finally, perhaps the terms of the buyout could be manipulated to prevent the possibility of the corporation facing a significant cash drain. See, e.g., Meiselman v. Meiselman, 307 S.E.2d 551, 572-73 (N.C. 1983) (Martin, J., concurring) ("If it is determined that the granting of relief will be unduly burdensome to the corporation or other shareholders, the trial court should consider this in determining whether to grant relief and, if so, whether this should affect the purchase price or value attached to plaintiff's shares or the method of payment."); Bahls, *supra* note 14, at 328 n.258 ("Several state statutes permit the courts to order installment payments."); Hillman, *supra* note 27, at 83 (discussing the possibility of "structur[ing] installment payments with a commercially reasonable rate of interest over an extended period of time").

Of course, all of these suggestions diminish the amount that the minority shareholder receives as compensation for her investment. It is the majority shareholder, however, that has violated the mutual understandings of the parties. The minority shareholder, by contrast, has upheld her end of the deal. Thus, to the extent that these "adjustments" serve to diminish the minority's investment value, one could question whether they should be considered at all.

279. See *supra* text accompanying notes 270-73.

280. See Cox, *supra* note 144, at 631 ("Though great flexibility should be accorded managers on matters related to the conduct of the corporation's business, this is not necessarily the case regarding decisions that impact the relative rights of owners' interests in the firm. The former is more clearly the type of business activity which is best lodged with the firm's managers; the latter is not.") (footnote omitted).

281. See *supra* notes 255-56 and accompanying text.

282. As mentioned, the prevalent remedy for shareholder oppression is a buyout of the oppressed investor's holdings. See *supra* note 184 and accompanying text. Support for the buyout remedy exists in half the states, although the relevant statutes and judicial decisions differ in

perspective and the presumptive understandings does not impose an unreasonable burden on the majority shareholder.²⁸³

4. The End of Business Judgment Rule Deference

Courts have traditionally been reluctant to interfere with board decisions involving employment, management, or dividend matters.²⁸⁴ Indeed, when the majority's decisions on such matters are challenged, the courts often invoke the business judgment rule and its accompa-

their operation. See Thompson, *supra* note 35, at 718. In some states, the corporation or the shareholders are permitted by statute to purchase the shares of a minority shareholder seeking involuntary dissolution. See, e.g., ALASKA STAT. § 10.06.630 (Michie 1989); CAL. CORP. CODE § 2000 (West 1990); MICH. COMP. LAWS ANN. § 450.1189 (West 1990); MINN. STAT. ANN. § 302A.751 (subd. 2) (West 1992); N.J. STAT. ANN. § 14A:12-7(8) (West 1992); N.Y. BUS. CORP. LAW §§ 1104-a, 1118 (McKinney Supp. 1992); N.D. CENT. CODE § 10-19.1-115 (1985); RMBCA § 14.34(a) (1993). In other states, statutes authorize a court to order a buyout as one of several possible remedies in dissolution proceedings or in other litigation between shareholders. See, e.g., ARIZ. REV. STAT. ANN. § 10-216 (West 1990); ME. REV. STAT. ANN. tit. 13A, § 1123 (West 1992); S.C. CODE ANN. § 33-14-310(d)(4) (Law. Co-op. 1994); MODEL STAT. CLOSE CORP. SUPP. §§ 41, 42 (1993). Courts have also ordered buyouts as part of their general equitable authority. See, e.g., Orchard v. Covelli, 590 F. Supp. 1548, 1560 (W.D. Pa. 1984); Davis v. Sheerin, 754 S.W.2d 375, 380, 383 (Tex. App.—Houston [1st Dist.] 1988, writ denied); Thompson, *supra* note 35, at 720-21 ("Courts increasingly have ordered buyouts of a shareholder's interest by the corporation or the other shareholders even in the absence of specific statutory authorization."). The buyout remedy is not limited to dissolution proceedings; indeed, in the absence of a statute, buyouts have been ordered where a breach of fiduciary duty has been found. See *id.* at 723.

A buyout remedy provides the shareholder with the "fair value" of his investment. See *supra* note 185 and accompanying text. In a sense, therefore, the modified minority perspective limits the discretion of the close corporation majority shareholder only to the extent that the majority (or the corporation) is unwilling to bear the expense of a "fair value" buyout. See 2 O'NEAL, OPPRESSION, *supra* note 14, § 10:09, at 60 ("The buy-out feature in these statutes is desirable because it permits shareholders who want to preserve the enterprise as a going concern to buy out dissenters, and at the same time it provides an oppressed shareholder a fair price for his holdings." (emphasis added)); see also *supra* note 278 (noting the possibility of a court awarding a buyout on favorable terms to the majority when "majority fault" is absent). But see Hillman, *supra* note 27, at 70-75 (stating that "[t]he assumption that those who desire to avoid a dissolution of the corporate enterprise may easily do so by purchasing the interest of a dissatisfied minority shareholder ignores a number of problems which may be encountered by those who wish to continue the venture," and discussing those problems). It should be noted, however, that the conventional buyout may not compensate the minority shareholder for the employment and management participation components of her investment. See Moll, *supra* note 29, at 568-80.

283. Cf. Bradley, *supra* note 101, at 845 ("Protecting shareholders from mistreatment and the disappointment of reasonable expectations does not impose an unacceptable constraint on the majority shareholders' entitlement to flexibility.").

284. See, e.g., Wilkes v. Springside Nursing Home, Inc., 353 N.E.2d 657, 662 (Mass. 1976) ("[C]ourts fairly consistently have been disinclined to interfere in those facets of internal corporate operations, such as the selection and retention or dismissal of officers, directors and employees, which essentially involve management decisions subject to the principle of majority control."); Donahue v. Rodd Electrotype Co., 328 N.E.2d 505, 513 (Mass. 1975) ("[T]he plaintiff will find difficulty in challenging dividend or employment policies. Such policies are considered to be within the judgment of the directors." (footnote omitted)).

nying deference to the majority will.²⁸⁵ Because of this traditional reluctance to interfere with majority decisions, some majority perspective courts may become lenient in their scrutiny of the majority's legitimate business purpose—so lenient that their analysis resembles a conventional business judgment rule deference.²⁸⁶ Adoption of the modified minority perspective, however, necessarily implies that a deferential approach to the actions of the majority shareholder is inappropriate. Because employment discharges, management removals, and dividend denials can severely harm the value of the close corporation shareholder's investment,²⁸⁷ the majority's decision to take one or more of such actions must be legitimately scrutinized by a court to insure that the decision conforms to the understandings from the hypothetical bargains. Thus, because the modified minority perspective requires more than a surface inquiry into the majority's conduct,

285. See, e.g., Peeples, *supra* note 69, at 469 ("The declaration of dividends is always at the discretion of the board of directors. The business judgment rule protects such a decision." (footnote omitted)); *id.* at 477 ("The hiring, firing, and compensation of employees are ultimately board decisions and have always qualified as management decisions protected by the business judgment rule."); Ragazzo, *supra* note 19, at 47 n.125 ("The business judgment rule is seldom overcome on dividend questions."); *supra* note 281.

The business judgment rule "immunizes management from liability in corporate transaction[s] undertaken within both power of corporation and authority of management when there is [a] reasonable basis to indicate that [the] transaction was made with due care and in good faith." BLACK'S LAW DICTIONARY 200 (6th ed. 1990). Under the business judgment rule, the majority's substantive business decision is reviewed with a minimal level of scrutiny. See EASTERBROOK & FISCHER, *supra* note 48, at 93 ("Statements of the rule vary; its terms are far less important than the fact that [it] is a specially deferential approach."); Cox, *supra* note 144, at 628 (mentioning the "deferential presumptions dictated by the business judgment rule"). As Professors Cary and Eisenberg have observed, "under the [business judgment] rule the substance or quality of the director's or officer's decision will be reviewed, not under the basic standard of conduct to determine whether the decision was prudent or reasonable, but only under a much more limited standard." CARY & EISENBERG, *supra* note 33, at 603. In general, that more limited standard is mere rationality—i.e., a substantive business decision need only be "rational," as opposed to "reasonable," to be considered proper. See *id.* ("[T]he prevalent formulation of the standard of review of a substantive decision under the business-judgment rule is that the decision must be 'rational.'"); Cox, *supra* note 144, at 629 (noting that "the standard business judgment rule approach . . . uphold[s] unequal treatment on a showing of rational business judgment"). Under such a minimal standard of review, almost any justification advanced by the majority to defend its allegedly oppressive actions will survive judicial scrutiny. See CARY & EISENBERG, *supra* note 33, at 604 ("The rationality standard of review is much easier for a defendant to satisfy than a prudence or reasonability standard. . . . It is common to characterize a person's conduct as imprudent or unreasonable, but it is very uncommon to characterize a person's conduct as irrational.").

286. See Hillman, *supra* note 27, at 45 n.139 ("A court may also show great tolerance towards those in control by justifying questionable conduct as within the business judgment of the directors and officers."); see, e.g., Daniels v. Thomas, Dean & Hoskins, Inc., 804 P.2d 359, 366-67 (Mont. 1990); see also *supra* note 204 and accompanying text.

287. See *supra* notes 189-190 and accompanying text.

conventional notions regarding the applicability of the business judgment rule must be disregarded.

At first glance, such bucking of tradition may seem like a startling proposition. It is important to note, however, that much of the core rationale for the business judgment rule is simply inapplicable in a close corporation context. Indeed, when market restraints are present, as in a public corporation, invoking the business judgment rule is sensible:

[T]he business judgment rule is a judicial expression of faith in the free market. If management in a public corporation performs well and corporate earnings rise, the increase in profitability will be reflected in the stock price. No necessity arises for judges to review decisions and strike down bad ones, because that is done by the market. . . . Poor performance of the management could lead to more drastic consequences. It could invite proxy fights or takeover bids, and thus threaten management's lucrative employment positions. Self-interest ensures that there is an incentive to good performance. . . . Judicial review is replaced for the better by a properly functioning market, because the market constantly reviews a corporation's performance and has immediate economic weapons to deal with mismanagement that are unavailable to the judiciary.²⁸⁸

In a close corporation, however, market restraints are not present. As a consequence, this core rationale for the business judgment rule is inapplicable:

The close corporation is not comparably reviewed or controlled by the market because it has no publicly traded stock. There is little possibility of a proxy fight or a takeover bid. In a close corporation, management has tremendous job security, which is often why the principals decided to incorporate. The absence of judicial review remains unsubstituted. Because of the absence of judicial review, the business judgment rule is not an expression of faith in the free market; worse, it is often an abdication of judicial responsibility to protect the powerless.²⁸⁹

288. Chittur, *supra* note 204, at 158. Professors Hetherington and Dooley express similar sentiments:

Market restraints are most visible and workable in the case of publicly held corporations. If management is inefficient, indulges its own preferences, or otherwise acts contrary to shareholder interests, dissatisfied shareholders will sell their shares and move to more attractive investment opportunities. As more shareholders express their dissatisfaction by selling, the market price of the company's shares will decline to the point where existing management is exposed to the risk of being displaced through a corporate takeover. . . . The mere threat of displacement, whether or not realized, is a powerful incentive for managers of publicly held corporations to promote their shareholders' interests so as to keep the price of the company's shares as high and their own positions as secure as possible.

Hetherington & Dooley, *supra* note 1, at 39-40 (footnote omitted).

289. Chittur, *supra* note 204, at 158 (footnote omitted); *see id.* at 155 ("When courts dismiss actions by minority shareholders under doctrinal corporate defenses, such as the business judgment rule, hostage-taking has a judicial guardian. A refusal to 'interfere in the legitimate business decisions of a corporation just to resolve a dispute between majority and minority shareholders' is in reality, a conferment of legitimacy on decisions that might have little to do with business." (footnote omitted) (quoting *Iwasaki v. Iwasaki Bros.*, 69 P.2d 598, 601 (1982)));

Because the market-based underpinnings of the business judgment rule are absent in the close corporation context,²⁹⁰ close corporation decisions call for more judicial scrutiny than the conventional business judgment rule deference.²⁹¹ To the extent that the scrutiny of majority perspective courts begins to resemble this deference, such laxity is inappropriate. When employment, management, or dividend matters are at issue in the close corporation, the adoption of the modified minority perspective and the presumptive understandings conveys that a closer judicial look is needed.²⁹²

VI. CONCLUSION

Courts and commentators have not fully considered the differences between the majority and minority perspectives of shareholder

see also Hetherington & Dooley, *supra* note 1, at 48 (“The preferred status of the majority [in a close corporation] is more likely to be an inadvertent product of a failure to appreciate the importance of market forces in the regulatory scheme for business organizations.”).

290. *See, e.g.*, Rosenfield v. Metals Selling Corp., 643 A.2d 1253, 1262 n.18 (Conn. 1994) (“The market for corporate control serves to constrain managers’ conduct that does not maximize shareholder wealth. It therefore serves to align the interests of managers more closely with the interests of shareholders in publicly traded corporations. The market for corporate control does not affect, however, the incentives of managers of closely held corporations.”); *supra* Part V.A.1.

291. *See, e.g.*, Easterbrook & Fischel, *supra* note 203, at 291; *see also supra* note 289 and accompanying text. Indeed, as Professors Easterbrook and Fischel explain:

It could be argued that judges should treat the acts of managers of close corporations with suspicion, however, because of the absence of the disciplinary effects of the stock market and other market mechanisms. One rationale for the business judgment rule is that managers who make errors (and even those who engage in self-dealing) are penalized by market forces while judges who make errors are not. Thus managers have better incentives to make correct business decisions than do judges. *But if neither managers nor courts are disciplined by market forces, this justification has less force.*

For example, the decision to terminate an employee in a publicly held corporation is a classic example of the exercise of business judgment that a court would not second guess. In a closely held corporation, by contrast, termination of an employee can be a way to appropriate a disproportionate share of the firm’s earnings. It makes sense, therefore, to have greater judicial review of terminations of managerial (or investing) employees in closely held corporations than would be consistent with the business judgment rule. The same approach could be used with salary, dividend, and employment decisions in closely held corporations where the risks of conflicts of interest are greater.

Easterbrook & Fischel, *supra* note 203, at 291-93 (emphasis added); *see also* Chittur, *supra* note 204, at 156-61 (arguing that the business judgment rule is inappropriate for the close corporation); O’Neal, *supra* note 75, at 884-85 (criticizing the application of the business judgment rule to close corporations). *But see* Easterbrook & Fischel, *supra* note 203, at 291 (“On the other hand, the smaller number of participants in closely held corporations ensures that managers bear more of the costs of their actions and facilitates contractual arrangements between the parties to reduce the likelihood of self-dealing. The differences between publicly and closely held corporations, in other words, do not suggest unambiguously that the level of judicial scrutiny should vary or, if it does, in what direction.”).

292. *See supra* note 291.

oppression. Although characterizing the perspectives as “not contradictory” and having “little difference” in practice is accurate in the typical freeze-out scenario, this Article has argued that the choice of oppression perspective is of critical significance outside of this context. By exploring the distinctions between the pure and modified formulations of the perspectives, this Article has demonstrated that the success or failure of an oppression claim may turn entirely on the perspective from which shareholder oppression is viewed.

Recognizing that the choice of perspective is important, however, reveals a larger question that courts and commentators have overlooked—which perspective is superior? In assessing the various perspectives, this Article has argued that the right question inquires into what the shareholders would have bargained for at the venture’s inception. The right answer, therefore, is *not* a perspective that allows the close corporation investment to be harmed whenever any legitimate business purpose is served. Given the special nature of the close corporation investment, reasonable close corporation shareholders would have rejected such a “legitimate business purpose” arrangement had they bargained over it. As a consequence, the majority perspective—in both pure and modified formulations—fails to conform to the expectations held by the typical close corporation shareholder. The “less harmful alternative” restriction does not alter this conclusion, as it will likely be construed to favor corporate interests. Simply put, both formulations of the majority perspective insufficiently protect the unique components of the close corporation investment. Thus, neither formulation can be accepted as the superior oppression perspective.

The modified minority perspective, however, properly protects the distinctive expectations of the typical close corporation shareholder, as well as the various components of the close corporation investment. Indeed, this Article has established that the modified minority perspective is the only approach with the flexibility to enforce the likely understandings that reasonable close corporation shareholders would have bargained for at the inception of the venture. Whereas the pure minority perspective overprotects the minority’s interests, the modified minority perspective’s enforcement of these understandings strikes the appropriate balance between protecting the minority’s investment and preserving the majority’s discretion. As a consequence, such an approach should be viewed as the superior oppression perspective.

In short, the choice between majority and minority perspectives can make an outcome-determinative difference. The question of perspective, therefore, is a question that demands an answer. By demon-

strating the superiority of the modified minority perspective, this Article has provided one.

