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The Effectiveness of Involuntary Dissolution Suits as a Remedy for Close Corporation Dissension

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THE EFFECTIVENESS OF INVOLUNTARY DISSOLUTION SUITS AS A REMEDY FOR CLOSE CORPORATION DISSENSION

HARRY J. HAYNSWORTH*

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Intra-corporate dissension between shareholders in a close corporation that can lead to serious deadlock, corporate paralysis and attempted squeeze-outs or other oppressive action is well documented.[1] The purpose

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[1] *See* O'Neal, *Oppression of Minority Shareholders: Protecting Minority Rights*, 35 CLEV. ST. L. REV. 121 (1986). *See generally* F.H. O'NEAL & R. THOMPSON, O'NEAL'S OPPRESSION

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of this article is to discuss the available remedies for dealing with this dissension, placing particular emphasis on involuntary dissolution suits, since historically such suits have been the most common litigation remedy used by aggrieved shareholders. The basic conclusion reached is that for the most part judges have done a commendable job of balancing the expectation interests of minority shareholders against the inherent voting and management rights of majority shareholders, and of fashioning appropriate and innovative remedies to deal with oppression and other wrongful conduct. A second major conclusion is that statutory provisions which specifically authorize relief other than dissolution greatly enhance the probability that a judge will order an effective remedy in close corporation dissension litigation.

I. Background

A number of close corporation contractual and quasi-judicial statutory dispute resolution devices are potentially available. There are three basic types: (1) those that bring in an outside party to attempt a resolution of the dispute—a provisional director, custodial receiver, or arbitrator; (2) a buy-out agreement triggered by deadlock; and (3) a special right of dissolution.

A. *Third Party Devices*

1. Provisional Director

The basic concept behind the use of a provisional director is to have a third party temporarily act as a tie-breaker.[2] Consequently, it is an appropriate remedy only in those situations where the board of directors is evenly divided. It will not be effective if the vote of the provisional director cannot be determinative of the outcome on the particular issue or issues that triggered his or her appointment. For example, assume a case where the applicable state statute or contractual agreement among the shareholders requires a two-thirds vote for approval of a proposed merger or other fundamental corporate structural change, and a corporation has four directors who vote 2-2 on the issue in question. Even if the provisional director votes in favor of the proposed action, it will not pass

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OF MINORITY SHAREHOLDERS (2d ed. 1985)[hereinafter O'NEAL'S OPPRESSION OF MINORITY SHAREHOLDERS]; F.H. O'NEAL & J. DERWIN, EXPULSION OR OPPRESSION OF BUSINESS ASSOCIATES-"SQUEEZEOUTS" IN SMALL ENTERPRISES (1961).

[2] *See* H. HAYNSWORTH, ORGANIZING A SMALL BUSINESS ENTITY, § 5.03(b)(1)(1986)[hereinafter ORGANIZING A SMALL BUSINESS ENTITY]; Note, *Alternative Remedies to Dissolution Under the 1983 Illinois Business Corporation Act*, 1985 U. ILL. L. REV. 709, 715-23 [hereinafter *Alternative Remedies*].

because three out of five votes is only sixty percent.[3] Moreover, a provisional director can only break a deadlock on issues decided exclusively by the board of directors and is therefore not effective on any issue where approval by the shareholders is required, and the shareholders are deadlocked. In addition, if the dissension among the shareholders is protracted and deep-seated, as is often the case, the use of a provisional director may at best merely postpone for a short time a more permanent resolution of the underlying problems.[4] Finally, because a provisional director will be operating in an atmosphere similar to a lawyer who tries to represent both spouses in a marital breakup, it may be difficult to find anyone willing to assume this role even with liberal compensation and a strong indemnification agreement.

In spite of these drawbacks, a provisional director can be potentially helpful where dissolution is not inevitable. This device is less intrusive on management prerogatives and is also not as likely to have an adverse effect on the corporation's credit or public image as would the appointment of a custodian, discussed below.[5]

According to one recent article, fourteen states currently have special statutory provisions authorizing the court appointment of provisional directors.[6] Many of these statutes, however, have major defects. The Georgia statute,[7] for example, requires a petition by one-half of the directors, or holders of at least one-third of the shares, and authorizes removal of any court-appointed provisional director by majority vote of the shareholders. These requirements artificially limit the circumstances in which a minority shareholder will be able to file a petition for the appointment of a provisional director. Further, if a provisional director is appointed by a court, the majority shareholders may dismiss him at any time without court approval.

Contractual agreements between the shareholders liberalizing the statutory scheme may be used to overcome these statutory deficiencies.[8] Moreover, in a state having no specific statutory authorization, a provi-

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[3] The use of more than one provisional director will resolve this problem, assuming they vote the same way. N.J. STAT. ANN. § 14A:12-7(3)(West Supp. 1986)(specific authorization for appointment of more than one provisional director).

[4] *See, e.g., In re* O'Brien Machinery, Inc., 224 Cal. App. 2d 563, 36 Cal. Rptr. 782 (1964)(provisional director petitioned court to be relieved after one year in office).

[5] *See In re* Jamison Steel Corp., 158 Cal. App. 2d 27, 322 P.2d 246 (1958).

[6] *See Alternative Remedies* at 715. There are two basic types of statutes: (1) those that include specific provisions for a provisional director as part of an involuntary dissolution statute (*see, e.g.,* ILL. ANN. STAT. ch. 32, § 12.55(a)(1), (b)(Smith-Hurd 1985); and (2) those that are not directly tied to involuntary dissolution or any other statutory remedy (*see, e.g.,* DEL. CODE ANN. tit. 8, § 353 (1983)).

[7] GA. CODE ANN. § 14-2-142 (1982).

[8] For example, any shareholder could be given the right to file a petition for a provisional director in the event of a deadlock.

sion for appointing, compensating, and removing a provisional director without court approval may be included in the articles of incorporation, or as part of a shareholder voting agreement.[9]

2. Custodial Receiver

At least eleven states[10] have statutes specifically authorizing courts to appoint custodial receivers. Such receivers have full power to run all aspects of a deadlocked corporation as a going concern until further order of the appointing court.[11] Because a custodian in effect temporarily replaces the board of directors and all officers, he or she has significantly more power than a provisional director. This is the reason why the appointment of a custodian is generally considered a more radical remedy than the appointment of a provisional director.[12]

The custodial receiver remedy seems to work best in situations where the holders of the majority of voting shares have engaged in fraudulent or self-serving transactions, or other serious high-handed or oppressive conduct towards the minority shareholders, even though the corporation is profitable and dissolution is not likely.[13] A major problem created by the appointment of a custodial receiver is the potential negative impact on the corporation's credit standing and public image. Creditors and the public may not perceive the difference between a custodian and a liquidating receiver or a bankruptcy trustee.[14]

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[9] *Cf.* Lehrman v. Cohen, 42 Del. Ch. 222, 222 A.2d 800 (1966)(special class of stock whose only purpose was to elect an impartial provisional director).

[10] *See Alternative Remedies* at 723. Like the provisional director statutes, some of the custodian provisions are included as part of the involuntary dissolution statutory scheme (*see, e.g.*, Ill. Ann. Stat. ch. 32, § 12.55(a)(2), (c) (Smith-Hurd 1985)) while others are not directly tied to involuntary dissolution or any other remedy (*see, e.g.*, Del. Code Ann. tit. 8, § 226, 352 (1983)). In states that do not have specific statutory authorization for a custodian (and even in those that do), it may be possible to establish the procedures for appointing and removing a custodian in a shareholders agreement or in the articles of incorporation or by-laws. This technique avoids the time delay and notoriety of a judicial proceeding. *See infra* note 14 and accompanying text.

[11] Preservation of the business as a going concern as opposed to liquidation is the principal distinction between a custodian and a liquidating receiver.

[12] *See generally Organizing a Small Business Entity*, *supra* note 2, § 5.03(b)(3); Note, *supra* note 2, at 723-30.

[13] *See, e.g.*, ARC Mfg. Co. v. Konard, 321 Pa. Super. 72, 467 A.2d 1133 (1983); Wilderman v. Wilderman, 315 A.2d 610 (Del. Ch. 1974). *Cf.* Mayhue v. Mayhue, 336 Pa. Super 188, 485 A.2d 494 (1984)(divorce court has inherent equitable power to appoint a custodian receiver to prevent a husband from improperly siphoning off assets from a corporation in which his wife claims a marital interest).

[14] Some courts have appointed a "special fiscal agent" with specific financial powers as a means of attempting to avoid the potential stigma attached to a custodian. *See* Holi-Rest, Inc. v. Treloar, 217 N.W.2d 517 (Iowa 1974); Roach v. Marguilies, 42 N.J. Super. 243, 126 A.2d 45 (1956).

3. Arbitration

The use of arbitration as a means of resolving intra-corporate dissension in closely held corporations has increased substantially in recent years.[15] A majority of states will enforce binding arbitration agreements;[16] and even in states that do not, courts will, as a general rule, enforce a contractual provision requiring arbitration as a prerequisite to filing a court action on a particular dispute.[17]

Arbitration proceedings are generally less time-consuming and less expensive than ordinary litigation. The ability to choose as arbitrators persons who have expertise in the particular type of dispute also makes arbitration attractive as a close corporation dispute resolution device. On the other hand, arbitration often results either in the substitution of the judgment of one or more third parties for that of the managing shareholders or in a compromise solution that is unsatisfactory to both sides. It seems to work best as a technique to resolve disputes involving essentially factual issues such as the value of the corporation's stock, or whether a particular salary increase was justified. It is less successful when used in an attempt to resolve deep-seated management policy disputes.[18] Nevertheless, even if it fails to resolve a particular dispute, arbitration at least provides a cooling-off period.[19]

B. *A Buy-Out Agreement*

The illiquidity of close corporation stock is not only a major cause of intra-shareholder dissension, but it also contributes to the difficulty of remedying dissension once it occurs.[20] This is the reason that a buy-out

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[15] *See generally* F.H. O'Neal, Close Corporations §§ 9.08-9.25 (2d ed. 1971)[hereinafter O'Neal, Close Corporations]; Note, *Mandatory Arbitration as a Remedy for Intra-Close Corporation Disputes*, 56 Va. L. Rev. 271 (1970).

[16] *See* G. Wilner, Domke on Commercial Arbitration § 4.01 (rev. ed. 1984). At least twenty-five states and the District of Columbia have adopted the Uniform Arbitration Act, which specifically authorizes binding arbitration. *See* 7 U.L.A. 1 (Supp. 1986).

[17] *See, e.g.*, F.J. Siller and Co. v. Hart, 400 Mich. 578, 255 N.W.2d 347 (1977). *See generally* Domke on Commercial Arbitration, *supra* note 16, § 19:05.

[18] In effect, arbitration provides a losing party with a second chance to win. In some cases, this can be beneficial to minority shareholders. However, if, because of a veto power, the minority prevails on the issue in controversy when it is brought before the board of directors or shareholders, the majority can use arbitration as a potential means of negating the contractual veto powers given to the minority through class voting rights, supermajority voting rights, and other control distribution devices. These risks must be taken into account when advising clients on the advantages and disadvantages of arbitration.

[19] *See* Organizing a Small Business Entity, *supra* note 2 at § 5:03(b)(3) for arbitration clause drafting guidelines.

[20] A high percentage of close corporation litigation involves shareholders who are voluntarily or involuntarily inactive, estates of deceased shareholders, and heirs and

agreement can be a very effective dispute resolution device. The biggest drawback to a buy-out agreement, however, is the potential financial burden on the corporation and its shareholders. If the corporation declines to purchase the shares or for legal reasons cannot purchase the shares in question, the burden then falls upon the non-purchasing shareholders.

There are several types of buy-out arrangements that have been suggested as solutions for dissension and deadlock.[21] In addition to cost considerations, all of them have other serious limitations. Perhaps the most widely used type is a buy-sell shoot-out agreement under which a shareholder has the right to offer to buy out the remaining shareholder or shareholders, who in turn must agree to sell to the offeror or to purchase the offeror's stock on the same terms and conditions as the offer. The biggest danger presented by this type of an agreement is the possibility that the shareholder who triggers the buy-sell offer may end up being bought out even though he or she genuinely wants to be the purchaser.[22]

C. *Special Rights of Dissolution*

Most state business corporation statutes require at least a majority vote to approve a voluntary dissolution. In recent years, several states have enacted statutes granting minority shareholders a right to force dissolution in much the same way general partners may in a partnership. Generally, such statutes allow one or more minority shareholders the right to dissolve a corporation under circumstances specified in the articles of incorporation.[23] Even in states having no equivalent statute, it is probably possible to create such a right indirectly through a shareholder voting agreement requiring all the shareholders to vote in favor of dissolution under circumstances specified in the agreement.[24]

The most significant disadvantage of this device is the enhanced bargaining position it gives to the minority shareholders who can trigger the dissolution. In other words, it can create the possibility of minority tyranny. For this and other reasons, a special dissolution right is often

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legatees of founding shareholders. *See* O'NEAL'S OPPRESSION OF MINORITY SHAREHOLDERS, *supra* note 1 at §§ 2:03, :04.

[21] *See* ORGANIZING A SMALL BUSINESS ENTITY, *supra* note 2, § 5.03(c).

[22] This is exactly what occurred in the recent case of Fender v. Prescott, 101 A.D.2d 418, 476 N.Y.S.2d 128 (1984), *aff'd on other grounds*, 64 N.Y.2d 1077, 479 N.E.2d 225, 489 N.Y.S.2d 880 (1985).

[23] *See, e.g.*, DEL. CODE ANN. tit. 8 § 355 (1983). Analogizing a close corporation to a partnership is theoretically questionable in several respects. *See infra* note 289.

[24] *See* American Bank & Trust Co. v. Lied, 487 Pa. 333, 409 A.2d 377 (1979); Wolf v. Arant, 88 Ga. Ap. 568, 77 S.E.2d 116 (1953).

coupled with a first refusal purchase option on the part of the remaining shareholders.[25]

D. *Summary*

All too frequently neither the shareholders nor their attorneys seriously consider the possibility of dissension at the time a close corporation is organized. Consequently, none of the devices discussed in this section is incorporated into the corporation's articles of incorporation or a shareholder agreement; or, in the case of statutory dispute resolution remedies, the prerequisites to invoke them cannot be met when serious dissension arises.[26] Moreover, even if one of these remedies is available, it may not resolve the underlying causes of the disputes between the shareholders on a long-term basis. If the dissension cannot be resolved voluntarily, litigation of some type is likely to ensue. The next three parts explore the litigation alternatives.

II. Involuntary Dissolution Suits—General Principles and Existing Statutes

The traditional general rule is that in the absence of statutory authority, a court does not have the power to force a dissolution of a profitable corporation at the request of a shareholder.[27] Even where statutory authority exists, courts have generally followed a strict construction principle and have construed the statutes narrowly in recognition of the drastic effects of dissolution and the potential unfairness to the majority shareholders who, if the corporation is dissolved, are deprived of their inherent control rights as well as the going concern value of the business.[28]

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[25] *See* Con. Gen. Stat. Ann. § 33-384(g) (West 1960)(statutory buy-out right by majority where minority have special rights of dissolution). Even with this limitation, a special right of dissolution, in effect, gives the minority shareholders having this right, a "put," which can create a severe potential financial strain on the corporation and remaining shareholders. *See* Organizing a Small Business Entity, *supra* note 2 at § 5.03(d).

[26] *See supra* note 23 and accompanying text (provision in articles of incorporation necessary for special right of dissolution).

[27] *See* O'Neal, Close Corporations, *supra* note 15, § 9.27; J. Tingle, The Stockholder's Remedy of Corporate Dissolution 20-52 (1959)[hereinafter cited as Tingle].

[28] *See* Israels, *The Sacred Cow of Corporate Existence: Problems of Deadlock and Dissolution*, 19 U. Chi. L. Rev. 778, 781-85 (1952); Chayes, *Madam Wagner and the Close Corporation*, 73 Harv. L. Rev. 1532, 1545-49 (1960); Pachman, *Divorce Corporate Style: Dissention Oppression and Commercial Morality*, 10 Seton Hall L. Rev. 315, 330-32 (1979); *see generally* Tingle, *supra* note 27. *Cf.* Belcher v. Birmingham Trust Nat'l Bank, 348 F. Supp. 61, 147-53 (N.D. Ala. 1968)(corporation had over 300 employees); *In re* Random & Neidorff, 307 N.Y. 1, 7, 119 N.E.2d 563, 565 (1954)(involuntary dissolution constitutes "judicially imposed death"); Delaney v. Georgia-Pacific Corp., 278 Or. 305, 546 P.2d 277,

Every state now has a statute that authorizes involuntary dissolution in one or more circumstances.[29] These statutes vary considerably, however, and a few states have statutes that are so narrowly drawn that they are virtually useless as an effective device to resolve close corporation intra-shareholder dissension.[30]

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288 (1977)(dissolution would hurt minority as well as majority shareholders), *aff'd [rev'd] on other grounds*, 42 Or. App. 379, 601 P.2d 475 (1979); Capitol Toyota, Inc. v. Gervin, 381 So. 2d 1038, 1039 (Miss. 1980)(dissolution under the circumstances would constitute oppression of the majority by the minority).

In many cases, the only available purchaser of the assets, if the corporation is dissolved, will be the majority shareholders. If the majority shareholders are guilty of wrongdoing, a court ordered dissolution in this situation, in effect, ends up indirectly rewarding them for their malfeasance. This possibility has been discussed in some cases. *See, e.g.*, Wollman v. Litman, 35 A.D.2d 935, 316 N.Y.S.2d 526 (1970). *Cf. In re* Wiedy's Furniture Clearance Center, Co., 108 A.D.2d 81, 487 N.Y.S.2d 901 (1985). The majority shareholders may even be able to avoid any adverse tax consequences in the liquidation- repurchase situation. *See* I.R.C. § 368(a)(1)(C)(1982).

[29] ALA. CODE §§ 10-2A-195, -196 (1980); ALASKA STAT. §§ 10.05.540, .555 (1985); ARIZ. REV. STAT. ANN. §§ 10-097, -098 (1977)(and for electing close corporations §§ 10-215, -216); ARK. STAT. ANN. § 64-908 (1980); CAL. CORP. CODE §§ 1800-1808, 2000, 2001, (West 1977 & 1986 Supp.); COLO. REV. STAT. §§ 7-8-113, -116 (1973 & 1985 Supp.); CONN. GEN. STAT. ANN. §§ 33-382 to -387, (West 1960 & 1986 Supp.); DEL. CODE ANN. tit. 8 § 273 (1983); D.C. CODE ANN. § 29-419 (1981); FLA. STAT. ANN. § 607.274, .277 (West 1977); GA. CODE ANN. §§ 14-2-286, 287 (1982); HAWAII REV. STAT. § 416-128, -131, -132 (1976 & 1984 Supp.); IDAHO CODE §§ 30-1-97, -98 (1980 & 1986 Supp.); ILL. REV. STAT. ch. 32 §§ 12.50, .55, .60 (Smith-Hurd 1985 Replacement Vol.)(and for electing close corporations, ILL. ANN. STAT. ch. 32 § 1214 (Smith-Hurd 1985 Supp.)); IND. CODE § 23-1-7-3 (1984); IOWA CODE ANN. § 496A.94 (West 1962 & 1986 Supp.); KAN. STAT. ANN. §§ 17-6804, -6812, -6813 (1981); KY. REV. STAT. §§ 271A.470, .475, .480 (1983); LA. REV. STAT. ANN. § 12:143 (West 1969 & Supp. 1986); ME. REV. STAT. ANN. tit. 13A § 1111. 1115 (1981); MD. CORPS. & ASS'NS CODE ANN. § 3-413 (1974 & 1984 Supp.)(and for electing close corporations §§ 4-602, -603); MASS. GEN. LAWS ANN. ch. 156B §§ 99, 101 (Michie/Law. Co-op 1970 & 1985 Supp.); MICH. COMP. LAWS ANN. § 450.1825 (1973); MINN. STAT. ANN. §§ 302A.751, -.753 (West 1985); MISS. CODE ANN. §§ 79-3-187, -195, -203 (1973), MO. ANN. STAT. § 351.485 (Vernon 1966 & Supp. 1986); MONT. CODE ANN. §§ 35-1-921, -922 (1984); NEB. REV. STAT. §§ 21-2096 to -20103 (1983); NEV. REV. STAT. § 78.630 (1985); N.H. REV. STAT. ANN. § 293-A:95 (Supp. 1985); N.J. STAT. ANN. § 14A:12-7 (West 1986 Supp.); N.M. STAT. ANN. § 53-16-16 (Supp. 1986); N.Y. BUS. CORP. LAW §§ 1104, 1104-a, 1111, 1118 (McKinney 1986); N.C. GEN. STAT. §§ 55-125 to -127 (1982); N.D. CENT. CODE §§ 10-19.1-115, -116 (1985); OHIO REV. CODE ANN. § 1701.91 (Page 1985); OKLA. STAT. ANN. tit. 18, §§ 1.195 to -.197 (1986); OR. REV. STAT. §§ 57.595, -.600 (1985); PA. STAT. ANN. tit. 15,§§ 2107, 2108 (Purdon 1967 & Supp. 1986); R.I. GEN. LAWS § 7-1.1-90, -90.1, -91 (1985); S.C. CODE ANN. §§ 33-21-150 to -160 (Lawyers Co-op Supp. 1985); S.D. CODIFIED LAWS § 47-7-34 (1980); TENN. CODE ANN. §§ 48-1-1008, -1009 (1984); TEX. BUS. CORP. ACT ANN. art. 7.05, .06 (Vernon 1980)(and for electing Close Corporations art. 12.5 to .54 (Vernon Supp. 1986)); UTAH CODE ANN. § 16-10-89, -91, -92 (1986 Supp.); VT. STAT. ANN. tit. 11, § 2067 (1984); VA. CODE § 13.1-909 (Supp. 1986); WASH. REV. CODE ANN. § 23A.28, .70, .180 (1969 & Supp. 1986); W. VA. CODE §§ 31-1-41, -134 (1982); WIS. STAT. ANN. § 18.771 (West Supp. 1957 & 1985)(and for electing close corporations § 180.995 (1985 Supp.)); WYO. STAT. §§ 17-1-614, -615 (1977 & 1986 Supp.).

[30] *See* the discussion of the Massachusetts and Ohio involuntary dissolution statutes *infra* notes 280-81 and accompanying text. Some states with narrow involuntary dissolution

A. *Statutory Jurisdictional Requirements*

The most prevalent type of involuntary dissolution statute follows the format of Section 14.30 of the Model Business Corporation Act.[31] As a general rule these statutes establish three types of jurisdictional criteria: (1) director or shareholder deadlock, (2) waste or misapplication of corporate assets, and (3) fraudulent, illegal, or oppressive conduct.

1. DEADLOCK

Director or shareholder deadlock is the most widely recognized statutory ground for involuntary dissolution.[32] Two factors, however, limit the number of situations in which deadlock will be found to exist.

First, deadlock is generally defined as corporate paralysis of such a magnitude that the corporation simply cannot function, and is in danger of imminent financial disaster.[33] Language such as "irreparable injury to

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statutes have caselaw precedent for court-ordered involuntary dissolution or related remedies under conditions similar to states having broader statutes. Delaware falls into this category. *See* Whitman v. Fuqua, 549 F. Supp. 315 (W.D. Pa. 1982). Many courts, however, have held that the statute is exclusive. *See, e.g.*, Schrage v. Portsmouth Steel Corp., 207 F.2d 497 (6th Cir. 1953); Alkire v. Interstate Theatres, Corp., 379 F. Supp. 1210 (D. Mass. 1974).

[31] MODEL BUSINESS CORP. ACT § 14.30 (1984)[hereinafter MBCA]. § 14.30 incorporates essentially the same wording that was used in § 97 of the 1969 MBCA. Thirty-two states follow the basic format of the MBCA; but many of the statutes contain significant differences that make broad generalizations hazardous. The MBCA format states are: Alabama, Alaska, Arkansas, Colorado, Georgia, Idaho, Illinois, Iowa, Kentucky, Maine, Maryland, Minnesota, Mississippi, Missouri, Montana, Nebraska, New Mexico, North Dakota, Oregon, Pennsylvania, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Utah, Vermont, Virginia, Washington, West Virginia, Wisconsin and Wyoming. The remaining involuntary dissolutions statutes do not follow any patterns that can be easily classified.

[32] Deadlock is listed as a reason for involuntary dissolution in all state business corporation codes except in Michigan, Nevada, and New Hampshire. The involuntary dissolution statutes in these states, however, contain other language that potentially obviates the need for a specific deadlock provision. *See* MICH. COMP. LAWS ANN. § 450.1825 (West 1973)("willfully unfair or oppressive" conduct); NEV. REV. STAT. § 78.630 (1979)(the corporation "has been or is being conducted at a great loss and greatly prejudicial to the interest of its creditors and shareholders"); N.H. REV. STAT. ANN. § 293-A:95 (Supp. 1985)("whenever actual or impending insolvency or other causes renders its liquidation reasonably necessary for the protection of the rights of stockholders or creditors"). The Delaware and Kansas involuntary dissolution statutes only cover deadlock of joint venture corporations involving two fifty percent owners. *See* DEL. CODE ANN. tit. 8 § 273 (1983); KAN. STAT. ANN. §§ 17-6804 (1981). Additional statutes in both these states, however, give a court power to appoint a custodian or a provisional director in a deadlocked close corporation. *See* DEL. CODE ANN. tit. 8 §§ 226, 352, 353 (1983); KAN. STAT. ANN. § 17-7212, -7213 (1981). *See also* Whitman v. Fuqua, 549 F. Supp. at 322-23 (inherent power of courts to order involuntary dissolution of a Delaware corporation).

[33] *See, e.g.*, *Whitman*, 549 F. Supp. 315. Jackson v. Nicolai-Neppach Co., 219 Or. 560,

the corporation," which is commonly included in deadlock statutes,[34] reinforces this limitation. The Model Act adds as an alternative, "or the business and affairs of the corporation can no longer be conducted to the advantage of the shareholders generally because of the deadlock."[35] This phrase broadens the circumstances justifying relief on the grounds of deadlock by focusing on the effect of the deadlock on the shareholders, rather than focusing simply on the economic effect of the deadlock on the corporation. There are many reported cases involving financially successful close corporations that are racked by bitter internal dissension.[36] Denying any relief unless the corporation is on the brink of insolvency does not seem to make sense from either an economic or a policy viewpoint.

Second, many decisions interpreting deadlock statutes have held that a deadlock exists only if there is a fifty-fifty split on the board of directors or between the shareholders.[37] Under this line of cases, shareholders who do not have the right to elect fifty percent of the directors or who own less than fifty percent of the corporation's voting shares can never successfully invoke an involuntary dissolution deadlock statute. Some cases, however, have recognized the existence of a deadlock where, because of supermajority voting rights required or authorized by statute, minority shareholders (or directors representing them on the board of directors)

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348 P.2d 9 (1959); Bator v. United Sausage Co., 138 Conn. 18, 81 A.2d 442 (1951). *See generally* Comment, *Deadlock and Dissolution in the Close Corporation: Has the Sacred Cow Been Butchered?*, 58 NEB. L. REV. 791, 814-824 (1979).

Even though a court may be unwilling to order dissolution of a corporation, if the facts indicate that fraud or other overreaching conduct has taken place, the plaintiff may be able to convince the judge to appoint a custodian receiver who will take over the management of the business. *See, e.g.*, ARC Mfg. Co. v. Konard, 467 A.2d 1133 (Pa. Super. 1983); Wollman v. Litman, 35 A.D.2d 935, 316 N.Y.S.2d 526 (1970). *See also supra* notes 10-14 and accompanying text.

[34] *See, e.g.*, MBCA, *supra* note 31, § 14.30. *Cf.* Gonseth v. K&K Oil Co., 439 S.W.2d 18 (Mo. App. 1969)(no relief where the only impact of the oppression was on the minority shareholder and did not damage the economic success of the corporation).

[35] *See, e.g.*, MBCA, *supra* note 31 § 14.30(2)(i). The Model Act also has a provision stating that deadlock exists when the shareholders have failed for at least two consecutive annual meetings to elect successors to directors whose terms have expired. *Id.* § 14.30(2)(iii). No requirement that the corporation be financially impaired by this type of deadlock is included in this provision. Although many states have a similar provision, it has not been invoked in very many reported cases.

[36] *See, e.g.*, Jackson v. Nicolai-Neppach Co., 219 Or. 560, 348 P.2d 9 (1959). *See generally* the cases discussed *infra* Part III, all of which involved financially successful businesses.

[37] *See* Herbert v. Royall of Pensacola, Inc., 259 So. 2d 750 (Fla. App. 1972); Dorf. v. Hill Bus Co., 140 N.J. Eq. 444, 54 A.2d 761 (1947); *In re* Binder, 172 Misc. 634, 15 N.Y.S.2d 44 (1939). *Cf.* OHIO REV. CODE ANN. § 1701.91(A)(4)(Page 1985)(even number of directors or an uneven number of directors and the shareholders are deadlocked and the holders of shares representing fifty percent of the voting power petition for an involuntary dissolution).

have a veto power over action proposed by the majority shareholders.[38] These decisions are commendable, since the potential harm to the corporation and the shareholders is the same, regardless of whether the failure to obtain approval of proposed action is caused by supermajority voting rights or an evenly divided vote by the directors or shareholders.

2. Waste or Misapplication of Corporation Assets

Although a majority of states have statutes authorizing involuntary dissolution for waste or misapplication of corporate assets, there have been few cases decided specifically on this ground. Courts generally combine waste and misapplication of assets with fraud, illegality, and oppression, without differentiating between the two categories. Analytically, this category properly includes involuntary dissolution cases involving excessive salaries and bonuses, payment of personal debts and expenses from corporation funds, and other situations involving self-dealing and preferential use of corporate assets by the controlling shareholders.[39]

3. Fraud, Illegality and Oppression

As a general rule courts have placed fraud and illegality in one sub-category, which is frequently combined with cases involving waste and misapplication of assets. They have placed oppression and related concepts such as unfairly prejudicial conduct and persistent unfairness,

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[38] *See* Mordka v. Mordka Enters. Inc., 143 Ariz. 298, 693 P.2d 953 (Ariz. App. 1984); Ward v. Colord, 110 Ill. App. 2d 68, 249 N.E.2d 137 (1969); *In re* Hy-Lite Plastics, Inc., 8 Misc. 2d 101, 165 N.Y.S.2d 888 (1957). *See also* Roach v. Bynam, 403 So. 2d 187 (Ala, 1981)(dictum), *aff'd*, 437 So. 2d 69 (1983). Two states, Illinois and New Jersey, have statutes that specifically do not require an even division to trigger a deadlock involuntary dissolution suit. *See* Ill. Rev. Stat. ch. 32, § 12.50(b)(1) (Smith-Hurd 1985 Replacement Volume); N.J. Stat. Ann. § 14A:12-7(1)(b)(West 1986 Supp.).

[39] *See, e.g.*, Salvadore v. Connor, 87 Mich. App. 458, 276 N.W.2d 458 (1978); *In re* Villa Maria, Inc., 312 N.W.2d 921 (Minn. 1977); Segall v. Shore, 269 S.C. 31, 236 S.E.2d 316 (1977).

In the absence of specific statutory authorization for a direct action by a shareholder, many courts have held that claims for waste and mismangement, must be brought as derivative actions. *See, e.g.*, Galbreath v. Scott, 433 So. 2d 454 (Ala. 1983). *But see* Thomas v. Dickson, 250 Ga. 772, 301 S.E.2d 49 (1983)(direct actions allowed where no other shareholders or creditors affected); Zokoych v. Spalding, 36 Ill. App. 3d 654, 344 N.W.2 805 (1976)(corporation bankrupt). The potential problems for a plaintiff presented by derivative claims are explored in Part IV. *See infra* notes 257-61 and accompanying text.

which are used in addition to or in lieu of oppression in some involuntary dissolution statutes,[40] in a separate sub-category.[41]

In recent years courts have increasingly focused on developing the concept of oppression, and proof of oppressive conduct is rapidly becoming the most likely avenue for minority shareholder relief in close corporations.[42] Three definitions of oppression have been used in the cases.

The first, drawn from English case law is:

> burdensome, harsh and wrongful conduct . . . a lack of probity and fair dealing in the affairs of a company to the prejudice of some portion of its members; or a visual departure from the standards of fair dealing, and a violation of fair play on which every shareholder who entrusts his money to a company is entitled to rely.[43]

Under this definition, oppression is basically a breach of the general fiduciary duty of good faith and fair dealing that majority shareholders in a corporation owe to the minority shareholders.[44]

The second definition, first enunciated in the now famous case of *Donahue v. Rodd Electrolyte Company of New England, Inc.*,[45] is conduct

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[40] *See, e.g.*, S.C. CODE ANN. § 33-21-150 (Law. Co-op. 1985 Supp.)("oppressive or unfairly prejudicial" conduct); MINN. STAT. ANN. § 302A.751(a)(2)(West 1986)("unfairly prejudicial"); CAL. CORP. CODE § 1800(b)(4)(West Supp. 1977 & 1986)("persistent unfairness"), (b)(5)("liquidation is reasonably necessary for the protection of the rights and interests of the complaining shareholder or shareholders"). *See also* MICH. COMP. LAWS ANN. § 450.1825 (West 1973)("willfully unfair or oppressive"); NEV. REV. STAT. § 78.630(1)(1982)("greatly prejudicial to the interest of its creditors or stockholders"); N.J. STAT. ANN. §§ 14A:12-7(1)(C)(West 1986 Supp.)("the directors or those in control . . . have acted oppressively or unfairly"); N.C. GEN. STAT. § 55-125(a)(4)(1982)("[l]iquidation is reasonably necessary for the protection of the rights or interests of the complaining shareholders"). The substantive difference, if any, between oppression and the other related terms has not been discussed in any detail in the cases. See Hillman, *The Dissatisfied Participant in the Solvent Business Venture: A Consideration of the Relative Permanence of Partnership and Close Corporations*, 67 MINN. L. REV. 1, 44 at n. 134; Note, *Company Law—Minority Rights-Oppression Remedy—Diligenti v. RWMD Operations Kelowna, Ltd.*, 11 U.B.C. L. REV. 326 (1977).

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

[42] Many of the "oppression" cases have been brought as breach of fiduciary duty actions rather than involuntary dissolution actions. Most of the oppression cases are collected in Annot., 56 A.L.R.3d 358 (1974). *See also infra* Part IV at notes 262-82 and accompanying text for more detailed discussion of ficuciary duty breach cases.

[43] Comment, *Oppression as a Statutory Ground for Corporate Dissolution*, 1965 DUKE L. J. 128, 134 (1965)(quoting from Scottish Co-op Wholesale Soc'ty v. Meyer [1958] 3 All E.R. 66, 71, 86 (H.L. and Edler v. Elder & Watson, Ltd. 1952 Sess. Cas. 49, 55 (Scot.)). This quotation has often been cited in American cases. *See, e.g.*, Baker v. Commercial Body Builders, Inc., 264 Or. 614, 628-29, 507 P.2d 387, 393-94 (1973).

[44] *See, e.g.*, Masinter v. Webco Co., 262 S.E.2d 433, 440 (W. Va. 1980). *See generally* A. Henn & J. Alexander, LAWS OF CORPORATIONS §§ 235-42, 276 (3rd ed. 1983)[hereinafter LAWS OF CORPORATIONS].

[45] 367 Mass. 578, 328 N.E.2d 505 (1975). The *Donahue* case was not an involuntary

that constitutes a violation of the strict fiduciary duty of "utmost good faith and loyalty" owed by partners *inter se*. This standard, which is based on the analogy of close corporation shareholders who are active in management to general partners in a partnership, is theoretically higher than the "good faith and inherent fairness" standard normally applicable in a corporation.[46]

The third definition of oppression, initially derived from English case law,[47] and long advocated by Dean F. Hodge O'Neal[48] as well as other leading close corporation experts,[49] is conduct which frustrates the reasonable expectations of the investors. The reasonable expectations doctrine has been gaining wide acceptance in the past few years. Decisions in at least eight states have explicitly adopted this concept,[50] and decisions in at least nine additional states have implicitly recognized it.[51] The approval of the reasonable expectations doctrine by the New

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dissolution action. Because of restrictions in the Massachusetts involuntary dissolution statute, it had to be filed as a direct action for breach of fiduciary duty. *See infra* notes 281-82 and accompanying text. Nevertheless, the definition of oppression in *Donahue* has frequently been cited in close corporation involuntary dissolution suits. *See, e.g.*, Orchard v. Coveli, 590 F. Supp. 1548, 1559 (W.D. Pa. 1984). However, the strict standard of "utmost good faith and loyalty" in *Donahue*, was subsequently tempered to permit some oppressive conduct if done for legitimate business purposes. *See* Wilkes v. Springside Nursing Home, Inc., 370 Mass. 842, 353 N.W.2d 657 (1976).

[46] See *infra* note 289, for a critique of the analogy between close corporations and partnerships.

[47] *See, e.g.*, Ebrahimi v. Westbourne Galleries, Ltd. [1972] 2 All E.R. 492 (H.L.); *In re* a Company, [1983] 2 All E.R. 854.

[48] *See* O'NEAL'S OPPRESSION OF MINORITY SHAREHOLDERS, *supra* note 1, §§ 7:20, 10:11 to 10:14; O'Neal, *Close Corporations: Existing Legislation and Recommended Reform*, 33 BUS. LAW. 873, 885-88 (1978).

[49] *See* Afterman, *Statutory Protection for Oppressed Minority Shareholders: A Model for Reform*, 55 VA. L. REV. 1043, 1063-77 (1969); Hillman, *The Dissatisfied Participant in the Solvent Business Venture: A Consideration of the Relative Permanence of Partnerhsips and Close Corporations*, 67 MINN. L. REV. 1, 49-55, 75-87 (1982); Olson, *A Statutory Elixir for the Oppression Malady*, 36 MERCER L. REV. 627, 654-58 (1985); Note, *A Statutory Proposal Protecting Employment Expectations of a Close Corporation's Minority Shareholders*, 63 WASH. U.L.Q. 545 (1985).

[50] *See* Stefano v. Coppock, 705 P.2d 443 (Alaska 1985); Wilkes v. Springside Nursing Home, Inc., 370 Mass. 842, 353 N.E.2d 657 (1976); Capital Toyota, Inc. v. Garvin, 381 So. 2d 1038 (1980); Fox v. 7L Bar Ranch Co., 198 Mont. 201, 645 P.2d 929 (1982); Exadaktilos v. Cinnaminson Realty Co., Inc., 167 N.J. Super. 141, 400 A.2d 554 (1979); *In re* Kemp & Beatley, Inc., 64 N.Y.2d 63, 484 N.Y.S.2d 799, 473 N.E.2d 1173 (1984); Meiselman v. Meiselman, 309 N.C. 279, 307 S.E.2d 551 (1983); Masinter v. Webco Co., 262 S.E.2d 433 (W. Va. 1980). In addition, Minnesota has incorporated the reasonable expectations standard into its involuntary dissolution statute. *See* MINN. STAT. § 302A.751 subd. 3a (1985). The Minnesota statute is discussed in Olson, *A Statutory Elixir For the Oppression Malady*, 36 MERCER L. REV. 627 (1985).

[51] *See* Gidwitz v. Lanzit Corrugated Box Co., 170 N.E.2d at 135-36 (1960); Hackbart v. Holmes, 675 F.2d 1114 (10th Cir. 1982)(Colorado); Cressy v. Shannon Continental Corp., 378 N.E.2d 941 (Ind. App. 1978); Sauer v. Moffitt, 363 N.W.2d 269 (Iowa 1984); Goben v.

York Court of Appeals in the 1984 case of *In re Kemp & Beatley, Inc.*[52] is quite significant and will undoubtedly influence other courts.[53]

The most lucid jurisdictional statement of the reasonable expectations doctrine to date is contained in the case of *Meiselman v. Meiselman*,[54] decided by the North Carolina Supreme Court in 1983:

> These 'reasonable expectations' are to be ascertained by examining the entire history of the participants' relationship. That history will include the 'reasonable expectations' created at the inception of the participants' relationship; those 'reasonable expectations' as altered over time; and the 'reasonable expectations' which develop as the participants engage in a course of dealing in conducting the affairs of the corporation. The interests and views of the other participants must be considered in determining 'reasonable expectations.' The key is 'reasonable.' In order for plaintiff's expectations to be reasonable, they must be known to or assumed by the other shareholders and concurred in by them. Privately held expectations which are not made known to the other participants are not 'reasonable.' Only expectations embodied in understandings, express or implied, among the participants should be recognized by the court. Hillman, *The Dissatisfied Participant in the Solvent Business Venture: A Consideration of the Relative Permanence of Partnerships and Close Corporations*, 67 MINN. L. REV. 1, 77-81 (1983). Also, only substantial expectations should be considered and this must be determined on a case-by-case basis. These requirements provide needed protection to potential defendants in this type case. *Cf. Capitol Toyota v. Gerwin*, Miss., 381 So. 2d 1038 (1980). (Dissolution denied and relief limited to purchase of plaintiff's shares at book value as of the date he left employment with the corporation).
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> In short then, the 'right or interests' of a shareholder in any given case will not necessarily be the same 'rights or interests' of

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Barry, 234 Kan. 721, 676 P.2d 90 (1984); Allen v. Royale "16", Inc., 449 So. 2d 1365 (La. App. 1984); Salvadore v. Conner, 87 Mich. App. 664, 276 N.W.2d 458 (1979); Cerami v. Dignazio, 424 A.2d 881 (Pa. Sup. Ct. 1981); Zidell v. Zidell, Inc. 277 Or. 423, 560 P.2d 1091 (1977).

[52] 64 N.Y.2d 63, 484 N.Y.S.2d 799, 473 N.E.2d 1173 (1984). Prior to this decision by the New York Court of Appeals, several other New York cases had adopted the reasonable expectations theory. *See, e.g.*, O'Donnell v. Marine Repair Serv's, Inc., 530 F. Supp. 1199 (S.D.N.Y. 1982); *In re* Gene Barry One Hour Photo Processing Inc., 111 Misc. 559, 444 N.Y.S.2d 540 (1981); Topper v. Park Sheraton Pharmacy, Inc., 107 Misc. 2d 25, 433 N.Y.S.2d 359 (1980).

[53] *See* Stefano v. Coppock, 705 P.2d 443, 446 n.3 (Alaska 1985).

[54] 309 N.C. 279, 307 S.E.2d 551 (1983).

> any other shareholder. An articulation of those 'rights or interests' will necessarily require a case-by-case determination based on an examination of the entire history of the participants' relationship. . . . For plaintiff to obtain relief under the expectations analysis, he must prove that (1) he had one or more substantial reasonable expectations known or assumed by the other participants; (2) the expectation has been frustrated; (3) the frustration was without fault of plaintiff and was in large part beyond his control; and (4) under all of the circumstances of the case plaintiff is entitled to some form of equitable relief.[55]

Given the number of close corporation cases involving alleged squeeze-outs and other improper behavior and the development of the concept of oppression and related doctrines as an effective vehicle for courts to deal with intra-shareholder dissension, it is distressing that so many states have adopted narrowly drawn statutes preventing minority shareholders who have been wronged from being able to seek involuntary dissolution as a potential remedy in a significant number of circumstances. Deadlock, which is the most prevalent jurisdictional ground, is simply not broad enough to encompass many types of squeeze-outs and oppressive acts.[56] Yet in many states deadlock is the only jurisdictional ground for an involuntary dissolution suit.[57] The absence of oppression or a related term in many involuntary dissolution statutes is also disturbing.[58]

Some states have special statutes which authorize broad grounds for involuntary dissolution suits brought by close corporation shareholders.[59] In many cases, however, these statutes are only applicable if a corpora-

[55] *Id.* at 298-99, 307 S.E.2d at 563-64 (1983).

[56] *See supra* notes 32-38 and accompanying text.

[57] *See, e.g.*, IND. CODE § 23-1-7-3 (1976); MASS. GEN. LAWS ANN. ch. 156B § 99 (Michie/Law Co-op. 1979 & 1986 Supp.). The Delaware and Kansas involuntary dissolution statutes are limited to deadlocks in joint venture corporations having two fifty percent owners. *See* DEL. CODE ANN., tit. 8 § 273 (1983), KAN. STAT. ANN. § 17-6804 (1981).

[58] The statutes in fifteen states do not authorize involuntary dissolution on the grounds of oppression or a related concept such as unfairly prejudicial conduct: Arizona, Connecticut, Delaware, Florida, Georgia, Hawaii, Indiana, Kansas, Kentucky, Louisiana, Maine, Massachusetts, New Hampshire, Ohio, and Oklahoma. A sixteenth, Wisconsin, only authorizes oppression as a grounds for involuntary dissolution in a corporation that elects to be a statutory close corporation. *Compare* WIS. STAT. § 180.771 (1957) *with id.* 180.995(19)(Supp. 1985).

[59] *See, e.g.*, ARIZ. REV. STAT. ANN. §§ 10-097 (deadlock exclusive ground), 10-215 (1980)("deadlock or dispute" in an electing close corporation); N.J. STAT. ANN. §§ 14A:12-7(1)(West 1986 Supp.)(only deadlock except in corporations having 25 or fewer shareholders); N.Y. BUS. CORP. LAW §§ 1104 (general), 1104-a (special provision for shareholders owning 20 percent or more of a corporation whose stock is not regularly traded on an exchange)(McKinney 1986).

tion elects to be governed by the special close corporation statutes;[60] and the available evidence indicates that very few close corporations actually make the election.[61]

Many statutes complicate the jurisdictional problem by imposing an ownership percentage requirement as a prerequisite to an involuntary dissolution suit. The percentage ranges from ten percent in Connecticut and Nevada to fifty percent in Ohio.[62] The rationale for this type of limitation is at best flimsy. Somewhat similar limitations requiring security for expenses in derivative actions brought by shareholders owning a small number of shares have been severely criticized and are much less prevalent than was once the case.[63] Why should it make any difference how many shares a wrongfully squeezed-out shareholder owns? The ownership percentage requirement, in effect, provides an unintended statutory justification for squeeze-outs of minority shareholders having ownership interests below the specified percentage.[64]

In most cases, a minority shareholder with a valid cause of action who cannot qualify for an involuntary dissolution suit will be able to pursue a breach of fiduciary duty claim or some other cause of action. As is explained in Part IV, however, the other possible causes of action may not be as desirable as an involuntary dissolution suit for a number of reasons.

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[60] *See, e.g.*, ARIZ. REV. STAT. ANN. §§ 10-201 (1977); ILL. REV. STAT. ch. 32 §§ 1201-1204 (Smith-Hurd 1985 Supp.).

[61] *See* Blunk, *Analyzing Texas Articles of Incorporation: Is the Statutory Close Corporation Viable?*, 34 S.W.L.J. 941, 955-56 (1980); Shapiro, *The Statutory Close Corporation: A Critique and a Corporate Planning Alternative*, 36 MD. L. REV. 289, 290 n.11 (1976). Dykstra, *Molding the Utah Corporation: Survey and Commentary*, 7 UTAH L. REV. 1 (1960).

[62] *See* CONN. GEN. STAT. ANN. § 33-382(a)(West Supp. 1986)(ten percent except in cases involving deadlock); LA. REV. STAT. ANN. § 12:143B(1)(1969 & 1986 Supp.)(twenty percent and in addition ownership of the requisite amount for six months); MASS. GEN. LAWS ANN. ch. 156B § 99(b)(Michie/Law Co-op 1970 & 1986 Supp.)(forty percent); NEV. REV. STAT. § 78.630(1)(1982)(ten percent); N.H. REV. STAT. ANN. § 293-A:95 (West Supp. 1985)(twenty-five percent); N.Y. BUS. CORP. LAW § 1104-a (McKinney 1985 Replacement Volume)(twenty percent for grounds other than deadlock); OHIO REV. CODE ANN. § 1701.91(A)(Page 1985)(fifty percent). The Delaware and Kansas business corporation acts limit involuntary dissolution suits to joint venture corporations with two equal shareholders. *See* DEL. CODE ANN. tit. 8 § 273 (1983); KAN. STAT. ANN. § 17-6804 (1981). However, decisions in Delaware indicate that courts will order involuntary dissolution in other circumstances. *See* Whiteman v. Fuqua, 549 F. Supp. 315, 322-23 (W.D. Pa. 1982); Campbell v. Pennsylvania Indus., 99 F. Supp. 199 (D. Del. 1951). Since the Kansas statutory scheme is the same as that in Delware, the Delaware cases would presumably be followed by Kansas courts.

[63] *See* LAWS OF CORPORATIONS, *supra* note 44 § 372.

[64] These statutes also generate litigation to determine whether the requisite ownership interest exists. *See* Gunzberg v. Art-Lloyd Metal Prod. Corp., 112 A.D.2d 423, 492 N.Y.S.2d 83 (1985)(assignment from children); *In re* Gargano, 112 A.D.2d 225, 491 N.Y.S.2d 440 (1985); Lewis v. Jones, 107 A.D. 931, 483 N.Y.S.2d 868 (1985)(common law right to involuntary dissolution exists for shareholder owning less than the requisite 20 percent required by N.Y. BUS. CORP. LAW § 1104-a (McKinney 1986)).

B. *Remedies*

Assuming a court finds that the requisite jurisdictional basis for an involuntary dissolution suit exists, the next issue to be determined is the appropriate relief. Some courts have taken the position that in the absence of alternative forms of relief specified in the applicable statute, the judge's choices are limited to authorizing dissolution or dismissing the petition.[65] Most courts, however, have held that the trial judge has the inherent power to order any legal or equitable relief that will remedy the dissension, with dissolution being the last resort.[66] Appellate courts will, as a general rule, uphold the trial court's decision on the appropriate relief, if any, except in unusual cases involving clear evidence of abuse of discretion.[67] This deference to the trial judge's decision may result in what appears to be inconsistent opinions in cases involving essentially the same facts, thus making it difficult to predict with any degree of certainty the probable outcome in a particular case. It is justified by the trial judge's unique opportunity to view all the facts in their totality, to judge on the credibility of the witnesses, and to consider the most appropriate remedy for the particular situation. As the cases discussed in the next section of this article illustrate, trial courts have on the whole exercised their discretion in a skillful manner.

Several states have enacted statutes explicitly listing alternative forms of relief that can be granted in an involuntary dissolution suit.[68] The

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[65] *See* Gruenberg v. Goldmine Plantation, Inc., 360 So. 2d 884 (La. App. 1978); White v. Perkins, 213 Va. 129, 184 S.E.2d 315 (1972); Harkey v. Mobley, 552 S.W.2d 79 (Mo. App. 1977). *Cf.* Hines v. Plante, 661 P.2d 880 (Nev. 1983); Crippen Printing Co. v. Abel, 441 N.E.2d 1002 (Ind. App. 1982); Poulakidas v. Charlidis, 68 Ill. App. 3d 610, 386 N.E.2d 405 (1979)(reluctance of courts because of interference with management prerogatives and potential damage to the corporation's financial standing to appoint a receiver *pendente lite* after an involuntary dissolution suit is filed, unless there is imminent danger that the corporation's assets will be dissipated).

[66] *See, e.g.*, Baker v. Commercial Body Builders, Inc., 264 Or. 614, 507 P.2d 387 (1973); Burnett v. Int'l Tennis Corp., 80 Mich. App. 396, 263 N.W.2d 908 (1978); Roach v. Marqulies, 42 N.J. Super. 243, 126 A.2d 45 (1956).

[67] *See, e.g.*, Henry George & Sons, Inc. v. Cooper-George, Inc., 95 Wash. 2d 244, 249, 632 P.2d 512, 517 (Wash. 1981). *But see* Stumf v. C.S. Stumf & Sons, Inc., 47 Cal. App. 3d 230, 120 Cal. Rptr. 671 (1975)(court must order dissolution if the jurisdictional elements are met; but the defendants can avoid liquidation by purchasing the plaintiff's shares).

[68] *See* ARIZ. REV. STAT. ANN. § 10-216 (1977)(only applies to statutory electing close corporations); ILL. REV. STAT. ch. 32, § 12.55 (Smith-Hurd 1985 Replacement Volume); MICH. COMP. LAWS ANN. § 450.1825(2) (West 1973); N.J. STAT. ANN. § 14A:12-7 (West 1986 Supp.); N.C. GEN. STAT. § 55-125.1 (1982); S.C. CODE ANN. § 33-21-155 (Law. Co-op. Supp. 1986); TEX. BUS. CORP. ACT. ANN. art. 12.52 (Vernon 1980)(only applies to electing close corporations); WIS. STAT. § 180.995(19)(Supp. 1986)(applies to electing close corporations). Several states have statutes that authorize other relief without specifically listing the types of relief. *See* CAL. CORP. CODE § 1804 (West 1977 & 1986 Supp.)(a "court . . . with or without winding up and dissolution, may make such orders and decrees and issue such injunctions in the case as justice and equity require"); MINN. STAT. ANN. § 302A.751 subd. 2, 3, 3a (West

most complete formulation of the various potential remedies is found in Section 41-43 of the Statutory Close Corporation Supplement to the 1984 Model Business Corporation Act.[69]

Section 41, which is titled "ordinary relief," authorizes a court to order one or more of the following:

> (1) the performance, prohibition, alteration, or setting aside of any action of the corporation or of its shareholders, directors, or officers of or any other party to the proceeding;
> (2) the cancellation or alteration of any provision in the corporation's articles of incorporation or bylaws;
> (3) the removal from office of any director or officer;
> (4) the appointment of any individual as a director or officer;
> (5) an accounting with respect to any matter in dispute;
> (6) the appointment of a custodian to manage the business and affairs of the corporation;
> (7) the appointment of a provisional director (who has all the rights, powers, and duties of a duly elected director) to serve for the term and under the conditions prescribed by the court;
> (8) the payment of dividends;
> (9) the award of damages to any aggrieved party.[70]

Section 41 also authorizes a court to award one or more of the parties reimbursement of all reasonable expenses including counsel fees and the expenses of appraisers or other experts when one of the other parties is found to have acted "arbitrarily, vexatiously, or otherwise not in good faith."[71] Section 42 of the Statutory Close Corporation Supplement authorizes the court to order a shareholder to sell his shares at their fair value to the corporation or to one or more of the remaining shareholders if the remedies described in Section 41 are "inadequate or inappropriate."[72] Finally, Section 43 authorizes dissolution of the corporation as a last resort.[73] The tiering of remedies in Section 41-43 of the Statutory

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1985)("equitable relief," dissolution or a buy-out); N.H. REV. STAT. ANN. § 294:97 (West Supp. 1985)("or to grant such other relief as may be just"); TEXAS BUS. CORP. ACT. ANN. art. 7.06 (Vernon 1980)("all other remedies available either at law or in equity").

[69] The Model Statutory Close Corporation Supplement to the 1984 *Model Business Corporation Act* [hereinafter *MBCA Stat. Close Corp. Supp.*] is published in 4 *Model Business Corporation Act Ann.* 1803-79 (3rd ed. 1986 Supp.).

[70] This list is similar to that found in Baker v. Commercial Body Builders, Inc., 264 Or. 614, 632-33, 507 P.2d 387, 395-96. The list in *Baker* has been cited in several other cases. *See, e.g.*, Masinter v. Webco Co., 262 S.E.2d 433, 441 n.12 (W. Va. 1980).

[71] MBCA Stat. Close Corp. Supp., *supra* note 69, § 41(b).

[72] *Id.* § 42(a). The court can order the shares of any shareholder to be sold. §§ 42(b)-(d) contain provisions for determining the fair value of the corporation's shares and for structuring the terms of the buy-out.

[73] *Id.* § 43(a)(2)("all other relief ordered by the court under Section 41 or 42 has failed

Close Corporation Supplement basically reflects the actual result in involuntary dissolution suits.[74]

Many of the existing state alternative relief statutes have significant deficiencies. This is particularly true with respect to provisions authorizing a forced sale of stock, which, as will be pointed out in the next section,[75] is by far the most prevalent remedy ordered in involuntary dissolution suits. Several statutes, for example, quite properly specify that the price to be paid in a forced buy-out is the fair value of the shares in question, but require that the fair value be determined as of the day the involuntary dissolution suit was filed,[76] or in some cases, the day before the suit was filed.[77] The value of the shares on that date may be artificially depressed, however, because of oppressive action or other malfeasance by the majority shareholders. Assuming that damages for the majority shareholders' wrongdoing are included in the value of the shares to be sold, or alternatively, are awarded to the selling shareholder in addition to the fair value of the shares determined by the court, this potential problem is moot.[78] These possibilities are not clearly mandated by all the statutes in question. The New Jersey Corporation Code, however, adequately resolves this issue by authorizing a court to determine the value "as of the date of the commencement of the action or such earlier or later date deemed equitable by the court, plus or minus any adjustments deemed equitable by the court . . . ."[79]

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to resolve the matters in dispute"). Under § 43(a)(1), a court can also order the corporation dissolved if the grounds for involuntary dissolution specified in MBCA, *supra* note 31, § 14.30 exist.

[74] *See infra* Section III.

[75] *See infra* notes 143-54 and accompanying text.

[76] *See, e.g.*, MINN. STAT. ANN. § 302A.751 subd. 2 (West 1985).

[77] *See* N.Y. BUS. CORP. LAW § 1118 (McKinney 1986).

[78] *See* Scottish Co-op Wholesale Soc'y Ltd. v. Mayer, [1958] 3 All E.R. 66, 89 ("value which the shares would have had at the date of the petition if there had been no oppression"); Wolff v. Wolff, 67 N.Y.2d 638, 499 N.Y.S.2d 65, 490 N.E.2d 532 (1986). *See also* MBCA Stat. Close Corp. Supp., *supra* note 69, § 42(b)(4)("after the seller delivers his shares he has no further claim against the corporation, its directors, officers, or shareholders, other than a claim to any unpaid balance of the purchase price and a claim under any agreement with the corporation or the remaining shareholder that is not terminated by the court").

The purchaser can presumably recover on any cause of action he has against the selling shareholder as an offset against the purchase price determined by the court. *See* Baker v. Pratt, 176 Cal. App. 3d 370, 222 Cal. Rptr. 253, 260 (1986). *But see* Abrams v. Abrams-Rubaloff & Assoc's, Inc., 114 Cal. App. 3d 240, 170 Cal. Rptr. 656, 659 (1980). *Cf.* Miller v. Ruth's of North Carolina, Inc., 69 N.C. App. 153 316 S.E.2d 622 (N.C. App. 1984)(a plaintiff waived all rights to pursue other direct causes of action against the defendants when he failed to file exceptions to the buy-out order filed by the trial judge; defendants' counterclaim also dismissed on the grounds that the price of the shares reflected any claim the defendants had).

[79] N.J. STAT. ANN. § 14A:12-7(8)(a)(West 1986 Supp.). The Minnesota involuntary

The appropriate valuation standard in court-ordered buy-outs has caused some difficulties. Most statutes and cases apply the willing seller-willing buyer model used in dissenter's rights cases.[80] This means that the value should be based on a going concern basis rather than a liquidation basis, even though the lawsuit may be cast as an involuntary dissolution action.[81] The buy-out makes moot the liquidation issue, and a valuation based on liquidation unfairly prejudices the rights of the selling shareholder and unjustly enriches the remaining shareholders. The California involuntary dissolution statute, however, mandates a liquidation standard for a buy-out.[82] In one recent case,[83] the application of this standard resulted in a buy-out price of $355,000 even though the going concern value of the selling shareholder's shares was $482,500.

A related issue concerns whether one or more discounts should be considered in determining the value of shares bought out as a result of an involuntary dissolution suit.[84] An illiquidity discount is appropriate since it is consistent with the willing seller-willing buyer model.[85] Close corporation stock is inherently illiquid. A minority interest discount is inappropriate, however.[86] The imposition of a minority interest discount is inconsistent with the willing seller-willing buyer model. In addition, in

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dissolution buy-out statute contains similar wording. *See* MINN. STAT. ANN. § 302A.751 subd. 2 (West 1986). The Illinois involuntary dissolution statutes are inconsistent. ILL. ANN. STAT. ch. 32, § 1214 (Smith-Hurd 1985 Supp.), which applies to electing close corporations, specifies that the valuation date shall be "as of the close of the business on the day on which the petition for the dissolution was filed." ILL. ANN. STAT. ch. 32, § 12.55(g)(Smith-Hurd 1985 Replacement Volume), which applies to all business corporations other than electing close corporations, states that "the court shall determine the fair value of the shares as of such date as the court finds equitable." For an example of a case where a court determined the valuation date to be a date prior to the filing of the complaint, see Orchard v. Covelli, 590 F. Supp. 1548 (W.D. Pa. 1984).

[80] *See, e.g.*, MBCA Stat. Close Corp. Supp., *supra* note 69, § 42(b)(1); Taines v. Gene Barry One Hour Photo Processing, Inc., 123 Misc. 2d 529, 474 N.Y.S.2d 362 (1983).

[81] *See* Blake v. Blake Agency, Inc., 107 A.D.2d 139, 486 N.Y.S.2d 341, 347-48 (1985); Segall v. Shore, 269 S.C. 31, 236 S.E.2d 316 (1977).

[82] CAL. CORP. CODE § 2000 (West 1977 & Supp. 1986). *See* Ronald v. 4-C's Elec. Packaging, Inc., 168 Cal. App. 3d 290, 214 Cal. Rptr. 225 (Cal. App. 1985)(liquidation value as if the corporation is sold as a going concern rather than piecemeal).

[83] Abrams v. Abrams-Rubaloff & Assoc's, Inc., 114 Cal. App. 3d 240, 170 Cal. Rptr. 656, 661 (Cal. App. 1981).

[84] For a detailed discussion of valuations discounts, see Haynsworth, *Valuation of Business Interests*, 33 MERCER L. REV. 457, 488-97 (1982).

[85] *See, e.g., In re* Fleischer, 107 A.D.2d 97, 486 N.Y.S.2d 272 (1985)(twenty-five percent discount authorized).

[86] *See* Blake v. Blake Agency, Inc., 107 A.D.2d 139, 486 N.Y.S.2d 341, 349 (1985)(twenty-five percent lack of marketability authorized; additional fifteen percent minority interest discount held to be improper); *In re* Fleischer, 107 A.D.2d 97, 486 N.Y.S.2d 272 (1985); Brown v. Allied Corrugated Box Co., 91 Cal. App. 3d 477, 154 Cal. Rptr. 170 (1979). *Cf.* Woodward v. Quigley, 257 Iowa 1077, 133 N.W.2d 38, 42-44 (1965)(a minority interest discount is not appropriate in a dissenter's right case).

a case where a squeezed-out minority shareholder is ordered to sell his shares, a minority interest discount, in effect, unjustly rewards the remaining shareholders for their improper behavior. For similar reasons a key man discount should not be applied in a court-ordered buy-out.[87] Finally, a control premium should not, as a general rule, be imposed if the majority shareholders are ordered to sell their shares to the minority.[88]

The effect of a price established in a contractual buy-out agreement between the shareholders on a court ordered buy-out is unsettled. If the buy-out agreement does not cover the circumstances giving rise to the court-ordered transfer, or is an optional as opposed to a mandatory buy-out, then the contractual buy-out price should be considered merely as non-conclusive evidence of the fair value of the shares.[89] A stronger case, however, can be made for utilizing the contractual buy-out price if the agreement covers the factual situation, for example, in a termination of employment case.[90] Even in this situation, there could be circumstances that make the contractual price inequitable.[91] The Minnesota involuntary dissolution buy-out statute specifically recognizes this possibility, and authorizes the court to disregard the contractual buy-out price if the price or other terms specified are "unreasonable under all the circumstances of the case."[92]

A related problem concerns the right of the selling shareholder to prejudgment interest on the value of his or her shares. Some courts have expressed reluctance to award any interest that predates the forced sale order.[93] From the selling shareholder's perspective, however, the inabil-

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[87] There are no existing cases on this issue, however.

[88] *In re* Fleischer, 107 A.D.2d 97, 486 N.Y.S.2d 272, 275 (1985); *In re* Bird Precision Bellows, Ltd., [1985] 3 All E.R. 523 (A.D.) *affirming*, [1984] 3 All E.R. 444 (Ch. Div.). *But see* Ronald v. 4-C's Elec. Packaging, Inc., 214 Cal. Rptr. 225, 230 (Cal. App. 1985).

[89] *See* Hughes v. Sego Int'l., Ltd., 192 N.J. Super. 60, 469 A.2d 74 (1983); Anderson v. Clemons Mobile Home, Inc., 214 Neb. 283, 333 N.W.2d 900 (1983); *In re* Villa Maria, Inc., 312 N.W.2d 921; Baylor v. Beverly Book Co., 216 Va. 22, 216 S.E.2d 18 (1975).

[90] *See* Hughes v. Sego Int'l, Ltd., 469 A.2d 74 (recognizes possibility of a binding contractual buy-out price). The validity of an agreement that triggers a mandatory buy-out if any shareholder files an involuntary dissolution suit or any cause of action against another shareholder would be questionable. *See* Crippin Printing Co. v. Abel, 411 N.E.2d 1003 (contractual buy-out right and dissolution suit are independent claims); Baylor v. Beverly Book Co., 216 S.E.2d 18 (filing a dissolution suit is not an offer to sell).

[91] *See* Anderson v. Clemmons Mobile Home, Inc., 214 Neb. 283, 332 N.W.2d 900 (1983)(unfair to use buy-out price because of majority shareholders misconduct); *In re* Villa Maria, Inc., 312 N.W.2d 921 (Minn. 1981)(filing of involuntary dissolution suit superseded book value buy-out option agreement).

[92] MINN. STAT. ANN. § 302A.751 subd. 2 (West 1985). *See also* MBCA Stat. Close Corp. Supp., *supra* note 69, § 42(b)(in determining fair value the court is entitled to consider among other relevant evidence "any agreement among some or all of the shareholders fixing the price or specifying a formula for determining share value for any purpose").

[93] *See, e.g., In re* Bird Precision Bellows, Ltd. [1985] 3 All E.R. 523 (C.A.) *affirming*, [1984] 3 All E.R. 444 (Ch. Div.); Abrams v. Abrams-Rubaloff & Assoc's Inc., 170 Cal. Rptr.

ity to obtain prejudgment interest could be quite prejudicial, particularly if the value of the shares to be sold is determined several months or years after the suit is brought.[94] Inability to collect prejudgment interest can also provide an artificial incentive to the defendants in an involuntary dissolution suit to use delaying tactics. A statutory provision similar to that in New Jersey specifically giving a court the discretion to award interest "from the date determined by the court to be equitable,"[95] is an appropriate way to deal with this issue. Another alternative would be a provision modeled after Section 42 of the Uniform Partnership Act which authorizes a withdrawing partner in a dissolved partnership that continues without settlement of accounts to collect at his option, either interest on the value of his partnership interest, or the profits attributable to the continual use of his partnership capital.[96]

The absence of provisions in many of the involuntary dissolution statutes specifically dealing with the allocation of costs for experts and attorneys' fees is also troublesome. Courts have been very reluctant to order reimbursement to successful plaintiffs for these expenses even in egregious cases of wrongdoing,[97] although the inherent power to award at

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656, 661 (1981); Baker v. Pratt, 176 Cal. App. 3d 370, 222 Cal. Rptr. 253, 260-62 (1986)(even though one of the causes of action was for involuntary dissolution, the plaintiff might be entitled to some prejudgment interest for any damages attributable to other causes of action based on breach of fiduciary duty because there was statutory authority for discretionary awards of prejudgment interest in such cases; case was remanded in part to determine the appropriate amount, if any, of prejudgment interest).

[94] *See, e.g.*, Miller v. Ruth's of North Carolina, Inc., 69 N.C. App. 153, 316 S.E.2d 622 (1984)(six-year interval between filing of the action and the court ordered buy-out); Stefano v. Coppock, 705 P.2d 443 (Alaska 1985)(suit filed in 1976 and final decision in 1985; prejudgment interest awarded from 1974 when cause of action arose); Orchard v. Covelli, 590 F. Supp. 1548 (W.D. Pa. 1984)(prejudgment interest for seven years of $163,690 awarded). Curiously, the Rhode Island involuntary dissolution buy-out statute only authorizes prejudgment interest from "the date of the filing of the election to purchase such shares;" but, at the same time, specifies that the value of the shares is to be determined as of the day on which the involuntary dissolution order was filed. R.I. GEN. LAWS § 7-1.1-90.1 (1985). Since the buy-out petition can be filed at any time before a hearing on the dissolution, or thereafter in the discretion of the court, a situation could arise where the interval between the statutory valuation date and the statutory prejudgment interest date could be significant.

[95] N.J. STAT. ANN. § 14A:12-7(8)(d)(1986 West Supp.). This type of statute avoids the potential problem created by the wording of the Rhode Island buy-out statute discussed *supra* note 94. The prejudgment interest rate should be in the discretion of the judge and not be limited to the rate on judgments. *Compare In re* Fleischer, 107 A.D.2d 97, 486 N.Y.S.2d 272 (1985)(twelve percent) *with* Blake v. Blake Agency, Inc., 107 A.D.2d 139, 486 N.Y.S.2d 341 (nine percent).

[96] UNIF. PARTNERSHIP ACT § 42 (1914). *See* Davidian, *Corporate Dissolution in New York: Liberalizing the Rights of Minority Shareholders*, 56 ST. JOHN'S L. REV. 24, 70-74 (1981). The analogy between close corporations and partnerships is explored in Part V. *See infra* note 289.

[97] *See, e.g.*, Baker v. Pratt, 176 Cal. App. 3d 370, 222 Cal. Rptr. 253, 257-59 (1986); Miller v. Ruth's of North Carolina, Inc., 68 N.C. App. 40, 313 S.E.2d 849 (1984)(attorneys' fees

least attorneys' fees in cases involving fraud and bad faith is well established.[98] On the other hand, if the shareholders named as defendants in the suit prevail, they are not likely to be able, in the absence of specific statutory authority, to recover their attorneys' fees and other costs from the plaintiff, or to have these expenses reimbursed by the corporation, except to the extent that they can prove that the corporation benefitted from the suit.[99] A statutory provision giving a court authority to impose expert's fees and attorneys' fees as a sanction against any party found to have acted arbitrarily, vexatiously, or in bad faith, is the fairest manner of dealing with this issue.[100] Such a provision will create a disincentive for majority shareholders to use improper delaying tactics and unnecessarily expensive trial strategies while at the same time providing protection to the majority shareholders against frivolous actions and strike suits by disgruntled minority shareholders.

An additional deficiency in most of the statutes authorizing a buy-out is the absence of any provision specifically authorizing a court to require the seller to enter into a reasonable non-competition agreement.[101] Courts faced with this issue have expressed reluctance to include a covenant not to compete in the order requiring a stock sale.[102] This reluctance is perplexing because, as a general rule, courts have readily enjoined former shareholders of closely held corporations from competing

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would have been appropriate, however, if the action had been a derivative action rather than one for involuntary dissolution); Sauer v. Moffitt, 363 N.W.2d 269 (Iowa App. 1984). Some courts have awarded attorneys' fees to successful plaintiffs in involuntary dissolution suits, however. *See, e.g.*, Salvadore v. Conner, 276 N.W.2d 458 (Mich. App. 1978); Segall v. Shore, 269 S.C. 31, 236 S.E.2d 316 (1977).

[98] *See, e.g.*, Alyeska Pipeline Serv. Co. v. Wilderness Soc'y., 421 U.S. 240 (1975). *See generally* Rowe, *The Legal Theory of Attorney Fee Shifting: A Critical Overview*, 1982 DUKE L.J. 651.

[99] *See, e.g., In re* Levitt, 109 A.D.2d 502, 492 N.Y.S.2d 736, 742 (1985); *In re* Rappaport, 110 A.D.2d 642, 487 N.Y.S.2d 376, 378 (1985); Mardikos v. Arger, 116 Misc. 2d 1028, 457 N.Y.S.2d 371, 375 (1982).

[100] Several states have such statutes. *See, e.g.*, MINN. STAT. ANN. § 302A.751 subd. 4 (West Supp.1985); N.J. STAT. ANN. § 14A:12-7(10)(West Supp. 1986). *See also* MBCA Stat. Close Corp. Supp., *supra* note 69, § 41(b).

[101] *See* MBCA Stat. Close Corp. Supp., *supra* note 69, § 42(b)(2)(specific statutory authority for a court to impose a non-competition covenant on the seller.) A provision authorizing a court to order a selling shareholder to enter into a covenant not to compete is included as part of the Wisconsin statutory close corporation statute. *See* WIS. STAT. ANN. § 180.995(19) (West Supp. 1985).

[102] *See In re* Fleischer, 107A.D.2d 97, 486 N.Y.S.2d 272, 275 (1985). In Wolff v. Wolff, 67 N.Y.2d 638, 490 N.E.2d 532, 499 N.Y.S.2d 665 (1986), the New York Court of Appeals reversed that portion of the tiral court's order imposing a covenant not to compete against the plaintiff on the ground that the covenant was too broad. A more narrowly drafted covenant would, apparently, have been upheld. *See generally* Kessler, *Employment Arrangements in Close Corporations*, 11 SETON HALL L. REV. 187, 204-08 (1980). *Cf.* Lord v. Lord, 454 A.2d 830, 834 (Me. 1983)(court ordered wife transferring stock to husband incident to a divorce to sign a non-competition agreement).

directly for the corporation's customers, particularly where the contacts with customers on behalf of the former shareholder's new business began while the shareholder was still employed by the corporation.[103] The potential harm to the corporation and the remaining shareholders is self-evident, and from everyone's point of view, it is better to deal with this issue at the time of the order of sale than as part of a subsequent lawsuit between the parties. In this connection, if a court does not require a non-competition covenant, this fact should be taken into account in determining the fair value of the selling shareholder's shares.[104]

In order to provide maximum flexibility and to minimize the financial burden of a share purchase, involuntary dissolution statutes containing buyout provisions should allow the corporation or any shareholder to be a purchaser and should specifically authorize installment purchases. California and New Jersey, however, have statutes that require the corporation, or fifty percent of the shareholders, to file a petition to buy out a plaintiff's shares and require cash payment of the fair value of the shares.[105] In addition, the Illinois statute contains one provision[106] which allows only other shareholders, but not the corporation, to file a petition to buy out the plaintiff's shares; and another statute[107] allows a court on its own motion to order the sale of shares only to the corporation without mentioning the possibility of allocating some or all of the shares to the remaining shareholders in the event the corporation cannot for legal or financial reasons purchase the shares.[108]

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[103] *See, e.g.*, Smith-Shrader Co. v. Smith, 136 Ill. App. 3d 571, 483 N.E.2d 283 (1985); Agronic Corp. v. deBough, 21 Wash. App. 459, 585 P.2d 821 (1978). *Cf.* Mohawk Maintenance Co., Inc. v. Kessler, 52 N.Y.S.2d 276, 437 N.Y.S.2d 646, 419 N.E.2d 324 (1981)(enforcement of an unwritten covenant not to compete against a seller of a corporation with a substantial good will factor). *See generally* A. VALIULIS, COVENANTS NOT TO COMPETE: FORMS, TACTICS AND THE LAW § 1.6 (1985).

[104] *See* Abrams v. Abrams-Rubaloff & Assoc's, 170 Cal. Rptr. at 661 (1981)(value of a hypothetical covenant not to compete properly taken into account in determining the fair value of purchased shares; but the issue of whether a non-competition provision was included in the order of sale was not discussed in the opinion).

[105] *See* CAL. CORP. CODE § 2000 (West Supp. 1986); N.J. STAT. ANN. § 14A:12-7(8)(West Supp. 1986). *See also* CONN. GEN. STAT. ANN. § 33-384 (West 1960 & Supp. 1986)(cash deposit for the full amount of the purchase price must be paid to clerk of court at the time the shareholders exercise statutory purchase option; no right of the corporation to exercise purchase option specified). It may be possible to interpret the California and New Jersey statutes so that even though owners of fifty percent or more of the shares must file the buy-out petition, not all the petitioners have to actually participate in the purchase. There are no cases on this issue.

[106] ILL. REV. STAT. ch. 32, § 1214(1)(b)(Smith-Hurd Supp. 1985). This statute applies to involuntary dissolution suits involving statutory close corporations. The equivalent statute for other corporations authorizes the corporation or any other shareholder to file the buy-out petition. *Id.* § 12.55(g) (Smith-Hurd 1985 Replacement Volume).

[107] *Id.* § 12.55(g).

[108] State corporation codes contain a wide variety of restrictions on stock redemptions.

Buy-out statutes should also specify that the interest rate on any court-ordered installment purchase can be based on existing rates for similar privately negotiated close corporation installment sales and need not be limited to the state's interest rate on judgments.[109] They should also authorize a court to require security and personal guarantees for any court-ordered installment purchase.[110]

In short, the statutes should grant the courts discretion to include in the buy-out order any provision that competent lawyers would include in a privately negotiated buy-out agreement.[111]

Several of the buy-out statutes authorize the corporation or other shareholders to file a petition after an involuntary dissolution suit is filed, demanding the right to purchase the plaintiff's shares.[112] Under these statutes, once the petition is filed, the involuntary dissolution suit is stayed pending a determination of the fair value of the plaintiff's shares, and upon payment, the involuntary dissolution suit is presumably dismissed.[113] This type of statute is appealing not only because it avoids the possibility of an involuntary dissolution, but also because the majority shareholders can prevent a public airing of the corporation's internal dissension if the buy-out petition is filed before any hearings take place. In six states, however, the statutes do not give the trial court discretion to reject the buy-out petition if it is filed within a certain time period.[114] Yet the evidence, if allowed to be presented, may indicate that

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See Kummert, *State Statutory Restrictions on Financial Distributions by Corporations to Shareholders Part I*, 55 WASH. L. REV. 359 (1980); *Part II*, 59 WASH. L. REV. 185 (1984).

[109] *Compare* Blake v. Blake Agency, Inc., 486 N.Y.S.2d 341, 350 (1985)(prejudgment interest rate payable until full purchase price paid) *with In re* Fleischer, 486 N.Y.S.2d at 275 (1985) (twelve percent interest affirmed v. nine percent authorized in the *Blake* case).

[110] *See* MBCA Stat. Close Corp. Supp., *supra* note 69, § 42(b)(2); MINN. STAT. ANN. § 302A.751 subd. 2 (West 1985).

[111] *See generally*, ORGANIZING A SMALL BUSINESS ENTITY, *supra* note 2, § 5.04(c)(1986). The statute should, however, give the court discretion to deny one or more of these rights. *See, e.g.*, Taines v. Gene Barry One Hour Photo Processing, Inc., 474 N.Y.S.2d 362 (1983)(request of an installment purchase denied as punishment for defendants' behavior).

[112] *See* CAL. CORP. CODE § 2000 (West Supp. 1986); CONN. GEN. STAT. ANN. § 33-384 (West 1960 & Supp. 1986); ILL. REV. STAT. ch. 32 § 12.55(g)(Smith-Hurd 1985 Replacement Volume) and § 1214(b)(Smith-Hurd Supp. 1985)(applies to electing close corporations); MD. CORPS. & ASS'N CODE ANN. § 4-603 (1985); MINN. STAT. ANN. § 302A.752 subd. 2 (West 1985); N.J. STAT. ANN. § 14A:12-7(8)(West Supp. 1986); N.Y. BUS. CORP. LAW § 1118 (McKinney 1986); R.I. GEN. LAWS § 7-1.1-90.1 (Supp. 1985). Several other states have statutes allowing a court on its own motion to order a sale to the corporation or other shareholders. *See, e.g.*, S.C. CODE ANN. § 33-21-155 (Law. Co-op. Supp. 1986).

[113] *In re* Cristo Bros., Inc., 489 N.Y.S.2d 35, 64 N.Y.2d 975, 478 N.E.2d 176 (1985).

[114] *See* CAL. CORP. CODE § 2000 (West Supp. 1986); CONN. GEN. STAT. ANN. § 33-384 (West 1960 & Supp. 1986); MD. CORPS. & ASS'N CODE ANN. § 4-603 (1985); N.Y. BUS. CORP. LAW § 1118 (McKinney 1986); R.I. GEN. LAWS § 7-1.1-90.1 (Supp. 1985). Illinois has one statute which specifically gives the court authority to reject the buy-out petition but has another statute, applicable to electing statutory close corporations, that omits any mention of court

another remedy, including a purchase of the defendants' shares by the plaintiff, is the most appropriate remedy in the circumstances. In addition, the exercise of the buy-out right could prejudice other pending causes of action by the plaintiff against the defendants. In one recent case, for example, a court held that a plaintiff's derivative claim and a claim to compel payment of dividends were barred because the facts giving rise to these causes of action took place after the date established for the buy-out.[115] Even if any remaining causes of action survive, the plaintiff will have lost the negotiating leverage provided by the potential threat of involuntary dissolution.

For these and other reasons, this type of buy-out statute should include a provision giving the trial court the power to reject the buy-out offer if the plaintiff can make out a *prima facie* case that the forced buy-out would be prejudicial or inequitable.[116] Because the plaintiff is guaranteed the fair value of his or her shares, which will in most cases satisfy the main objective in bringing the suit, a hearing on the merits of the buy-out proposal will likely be requested only in exceptional circumstances. Yet, in these special circumstances, the right to a hearing is a desirable safeguard of the plaintiff's rights and is consistent with the wide discretion given to trial judges with respect to all other aspects of involuntary dissolution suits.[117]

III. Involuntary Dissolution Cases Decided in 1984-1985

A. *Statistical Analysis*

What results actually occur in close corporation involuntary dissolution suits? One way to answer this question is to examine existing

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discretion on this issue. *Compare* Ill. Rev. Stat. ch. 32, § 12.55(g)(Smith-Hurd 1985 Replacement Volume) *with id.* § 1214(b)(Smith-Hurd Supp. 1985). For a case holding that no evidentiary hearing on the merits of the dissolution cause of action is authorized once the buy-out petition is filed, *see* Abrams v. Abrams-Rubaloff & Assoc's, Inc., 114 Cal. App. 3d 240 (1981).

These statutes can present the defendants with a difficult procedural choice: if the buy-out right is exercised within the statutory time frame, the defendants give up the opportunity of prevailing on the merits in a trial; but if they do not exercise the statutory buy-out right, they assume the risk that the court may be unwilling to order or allow a buy-out at a subsequent stage or may order a buy-out at a lower price. *See* Gimpel v. Bolstein, 125 Misc. 2d 45, 477 N.Y.S.2d 1014, 1018 n.4 (1984).

[115] Miller v. Ruth's of North Carolina, Inc., 69 N.C. App. 672, 318 S.E.2d 2 (1984).

[116] *See* Minn. Stat. Ann. § 302A.751 subd. 2 (West 1985)(the court upon petition "may" order the sale); N.J. Stat. Ann. § 14A:12-7(8)(West Supp. 1986)("the court may order the sale by the plaintiff or plaintiffs of all shares of the corporation's stock held by them to either the corporation or the moving shareholders, whichever is specified in the motion, if the court determines in its discretion that such an order would be fair and equitable to all parties under all the circumstances of the case").

[117] *See supra* note 67 and accompanying text.

published opinions. For the purposes of this article, the opinions published in 1984 and 1985 in which involuntary dissolution was one of the major causes of action were analyzed. These two years were chosen simply because they were the two most recent years for which decisions were available. Given the number and variety of cases during 1984 and 1985, it is doubtful that increasing the number of years in the sample would have yielded any significantly different or additional conclusions.

The 1984 and 1985 involuntary dissolution cases present an interesting statistical profile. There were a total of forty-seven cases that qualified for the sample.[118] Forty-five of the cases came from twenty different states Alaska,[119] Arizona,[120] California,[121] Colorado,[122] Connecticut,[123] Georgia,[124] Idaho,[125] Illinois,[126] Iowa,[127] Louisiana,[128] Kansas,[129] Maryland,[130] Minnesota,[131] Montana,[132] Nevada,[133] New York,[134] North Caro-

[118] There were three separate opinions published in one of the cases, but it is counted as only one case for statistical purposes. *See* Miller v. Ruth's of North Carolina, Inc., 75 N.C. App. 233, 313 S.E.2d 849 (1984); 69 N.C. App. 153, 316 S.E.2d 622 (1984); 69 N.C. App. 672, 318 S.E.2d 2 (1984). Six additional cases were initially considered but ultimately rejected. Two of them involved cases where the trial court on its own motion ordered dissolution and the appellate court held that there was no authority for such action. Combre v. Warren's Family Drive-Inns, Inc., 680 P.2d 733 (Utah 1984); Owens v. Bricks, Inc., 703 S.W.2d 147 (Tenn App. 1985). One case was rejected because it was not clear from the opinion whether the suit was brought by a shareholder or a creditor. Waddell v. Trostel, 485 A.2d 1208 (Pa. Super. Ct. 1984). Two more were eliminated because it was not clear from the opinion whether involuntary dissolution of a corporation was one of the plaintiff's requests for relief. Rosenburg v. Rosenburg Brothers Special Account, 134 Mich. App. 342, 351 N.W.2d 563 (1984)(involved both a partnership and a corporation); Evans v. Blesi, 345 N.W.2d 775 (Minn. Ct. App. 1984)("damages and equitable relief"; court ordered a buy-out and enjoined both shareholders from filing for involuntary dissolution for two years). The sixth case was an involutnary dissolution suit filed against a publicly held corporation. Gottschall v. Jones & Laughlin Steel Corp., 482 A.2d 979 (Pa. Super. 1984).

[119] Stefani v. Coppock, 705 P.2d 443 (Alaska 1985).

[120] Mordka v. Mordka Enter's, Inc., 143 Ariz. 298, 693 P.2d 953 (Ariz. App. 1984).

[121] Ronald v. 4-C's Elec. Packaging, Inc., 168 Cal. App. 3d 290, 214 Cal. Rptr. 225 (1985); Baker v. Pratt, 173 Cal. App. 3d 1, 219 Cal. Rptr. 229 (1985), *vacated* 176 Cal. App. 3d 370, 222 Cal. Rptr. 253 (1986); Humes v. Margil Ventures, Inc., 174 Cal. App. 3d 486, 220 Cal. Rptr. 186 (1985); Hoiles v. Superior Court, 157 Cal. App. 3d 1192, 204 Cal. Rptr. 111 (1984); Resch v. Troy, Malin & Pottinger, 151 Cal. App. 3d 293, 198 Cal. Rptr. 504 (1984).

[122] Neusteter v. District Court, 675 P.2d 1 (Col. 1984).

[123] Bricklin v. Stengol Corp., 1 Conn. App. 656, 476 A.2d 584 (1984).

[124] Gregory v. J.T. Gregory & Son, Inc., 338 S.E.2d 7 (Ga. App. 1985).

[125] Gillingham v. Swan Falls Land & Cattle Co., 106 Idaho 859, 683 P.2d 895 (1984).

[126] Smith-Shrader Co. v. Smith, 136 Ill. App. 3d 571, 91 Ill. Dec. 1, 483 N.E.2d 283 (1985); Coduti v. Hellwig, 127 Ill. App. 3d 279, 82 Ill. Dec. 686, 469 N.E.2d 220 (1984).

[127] Sauer v. Moffitt, 363 N.W.2d 269 (Iowa App. 1984).

[128] Allen v. Royale, "16", Inc., 449 So. 2d 1365 (La. App. 1984); Baltazor v. Walden, 459 So. 2d 711 (La. App. 1984).

[129] Goben v. Barry, 234 Kan. 721, 676 P.2d 90 (1984).

[130] Valerino v. Little, 62 Md. App. 588, 490 A.2d 756 (1985).

[131] Schaub v. Kortgard, 372 N.W.2d 427 (Minn. App. 1985).

lina,[135] Pennsylvania,[136] South Carolina,[137] and Texas.[138] The remaining two are from Great Britain.[139] They were included in the sample first, because historically the English close corporation dissension decisions have been influential in the United States;[140] second, because these two cases illustrate certain points that are not present in the American decisions; and third, because their inclusion does not significantly affect any of the statistical data.

Ten of the cases in the sample involved technical legal issues in which no decision on the type of relief, if any, had been made at the time the opinion was issued.[141] Although many of these opinions decided impor-

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[132] Maddox v. Norman, 697 P.2d 1368 (Mont. 1985).

[133] Johnson v. Steel, Inc., 678 P.2d 676 (Nev. 1984).

[134] *In re* Cristo Bros., Inc., 64 N.Y.S.2d 975, 489 N.Y.S.2d 35, 478 N.E.2d 970 (1985); *In re* Kemp & Beatley, Inc., 64 N.Y.2d 63, 484 N.Y.S.2d 799, 473 N.E.2d 1173 (1984); *In re* Wiedy's Furniture Clearance Center Co., 108 A.D.2d 91, 487 N.Y.S.2d 901 (1985); *In re* DuBonnet Scarfs, Inc., 105 A.D.2d 339, 484 N.Y.S.2d 541 (1985); *In re* Levitt, 109 A.D.2d 502, 492 N.Y.S.2d 736 (1985); *In re* Gargano, 112 A.D.2d 225, 491 N.Y.S.2d 440 (1985); *In re* Rappaport, 110 A.D.2d 639, 487 N.Y.S.2d 376 (1985); Gunzberg v. Art-Lloyd Metal Prod's Corp., 112 A.D.2d 423, 492 N.Y.S.2d 83 (1985); Blake v. Blake Agency, Inc., 107 A.D. 139, 486 N.Y.S.2d 341 (1985); *In re* Fleischer, 107 A.D.2d 97, 486 N.Y.S.2d 272 (1985); Lewis v. Jones, 107 A.D.2d 931, 483 N.Y.S.2d 868 (1985); Wolff v. Wolff, 112 A.D.2d 850, 492 N.Y.S.2d 763 (1985); *In re* Mintz, 112 A.D.2d 803, 493 N.Y.S.2d 488 (1985); Ricci v. First Time Around, Inc., 112 A.D.2d 794, 112 A.D.2d 795, 492 N.Y.S.2d 295 (1985); Rosen v. Hofteller Enterprises, Inc., 102 A.D.2d 855, 476 N.Y.S.2d 625 (1984); Gimpel v. Bolstein, 125 Misc. 45, 477 N.Y.S.2d 1014 (1984); *In re* Trocino, 126 Misc. 2d 394, 482 N.Y.S.2d 670 (1984); *In re* T.J. Ronan Paint Corp., 98 A.D.2d 413, 469 N.Y.S.2d 931 (1984). The large number of cases from New York is probably due to trials and appeals from the inital batch of cases filed after New York in 1979 enacted special legislation allowing holders of twenty percent or more of the shares of a closely held corporation to file for involuntary dissolution on much broader grounds than was previously possible and authorizing the remaining shareholders to avoid involuntary dissolution by electing to buy-out the plaintiff's shares. *See* N.Y. BUS. CORP. LAW §§ 1104-a, 1118 (McKinney 1986). *See supra* notes 112-17 and accompanying text and *infra* notes 194-96 and accompanying text for additional discussion of these New York statutes.

[135] Lowder v. All Star Mills, Inc., 75 N.C. App. 233, 330 S.E.2d 649 (1985); Miller v. Ruth's of North Carolina, Inc., 313 S.E.2d 849 (N.C. App. 1984); 69 N.C. App. 153, 316 S.E.2d 622 (1984); 69 N.C. App. 672, 318 S.E.2d 2 (1984).

[136] Orchard v. Covelli, 590 F.2d 1548 (W.D. Pa. 1984).

[137] Ward v. Ward Farms, Inc., 283 S.C. 568, 324 S.E.2d 63 (1984).

[138] Burnett v. Chase Oil & Gas, Inc., 700 S.W.2d 737 (Tex. App. 1985); Leck v. Pugh, 676 S.W.2d 180 (Tex. Civ. App. 1984).

[139] *In re Bird Precision Bellows Ltd.* [1985] 3 All E.R. 523 (Ct. App.), *affirming*, [1984] 3 All E.R. 444 (Ch. Div.); *In re* Zinotty Properties Ltd., [1984] 3 All E.R. 754 (Ch. Div.).

[140] *See supra* notes 42-55 and accompanying text. *See generally* O'NEAL'S OPPRESSION OF MINORITY SHAREHOLDERS, *supra* note 1, § 10:14.

[141] *See* Humes v. Margil Ventures, Inc., 174 Cal. App. 3d 486, 220 Cal. Rptr. 186 (1985)(involuntary dissolution suit and separate administrative action to have a contract terminated for lack of a proper license arising out of the same facts can proceed simultaneously without an election of remedies); Hiles v. Superior Court, 157 Cal. App. 3d 1192, 204 Cal. Rptr. 111 (1984)(the applicability of the attorney-client privilege and the

tant procedural points that could have a significant impact on the ultimate outcome of the case,[142] they will not be discussed further in this article.

Of the remaining thirty-seven cases, a buy-out was the most frequent relief ordered by the court or elected by the defendants. This result occurred in twenty of the decisions (fifty-four percent).[143] Dissolution was ordered in ten of the cases (twenty-seven percent). In four of the cases (eleven percent), no substantial relief was granted to the plaintiff on the merits. Finally, in the three other cases (eight percent) relief other than either dissolution or a buy-out was the exclusive remedy ordered; and in eleven of the dissolution and buy-out cases (thirty percent of the total and thirty-seven percent of the dissolution and buy-out cases), additional relief was also granted. This additional relief included compensatory damages, punitive damages, an accounting, cancellation of issued stock, partial liquidation and other innovative orders which will be discussed later in this section.

That a court-supervised buy-out was the predominant form of ultimate relief and that a buy-out occurred twice as frequently as a court-ordered liquidation is not surprising. A buy-out, assuming fair value is received for the shares, gives the plaintiff a cash-out right that he or she would not otherwise have, and in many cases, this is undoubtedly the principal motivation behind the lawsuit. Getting rid of a dissatisfied shareholder permanently is also advantageous to the corporation and remaining shareholders. Moreover, as was pointed out in the last section,[144] judges have consistently stated that dissolution should be ordered only as a last resort when no alternative remedy is feasible; and the dissolution cases in

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work product doctrine in an involuntary dissolution suit); Resch v. Troy, Malin & Pottinger, 151 Cal. App. 3d 293, 198 Cal. Rptr. 504 (1984); Neusteter v. District Court, 675 P.2d 1 (Col. 1984)(applicability of the accountant-client privilege in a combination derivative and involuntary dissolution action); Baltazor v. Walden, 459 So. 2d 711 (La. App. 1984); Johnson v. Steel, Inc., 678 P.2d 676 (Nev. 1984); Lewis v. Jones, 107 A.D.2d 931, 483 N.Y.S.2d 868 (1985)(common law right to involuntary dissolution exists in addition to statutory right and can be pursued even though the plaintiff has brought a separate derivative suit arising out of the same facts); *In re* Mintz, 113 A.D.2d 803, 493 N.Y.S.2d 488 (1955)(an evidentiary hearing must be held in a contested involutnary dissolution suit); Ricci v. First Time Around, Inc., 112 A.D.2d 794, 112 A.D.2d 795, 492 N.Y.S.2d 295 (1985)(same); Rosen v. Hofteller Enterprises, Inc., 102 A.D.2d 855, 476 N.Y.S.2d 625 (1984)(same).

[142] See the parentheticals following the citations in note 141 *supra*.

[143] In two of the New York cases the court ordered dissolution if the defendants did not purchase the plaintiff's shares. See *In re* Kemp & Beatley, Inc., 64 N.Y.2d 63, 484 N.Y.S.2d 799, 473 N.E.2d 1173 (1984); Gunzberg v. Art-Lloyd Metal Prod's Corp., 112 A.D.2d 423, 492 N.Y.S.2d 83 (1985). These cases were classified as buy-out cases rather than dissolution cases for two reasons: (1) the defendants were given a choice, so any liquidation was voluntary, not involuntary; and (2) the appropriate sanction for failure to comply with a buy-out order is liquidation. *See MBCA Model Stat. Close Corp. Supp. supra* note 69, § 42(a).

[144] *See supra* notes 27-28 and accompanying text.

the sample used in this article illustrate that in this instance, judges are practicing what they preach.

What is somewhat surprising is the number of cases in which a court-supervised buy-out is the result of the involuntary dissolution suit. In a previous study of the fifty-four involuntary dissolution opinions decided between 1960-1976 conducted by Professors J.A.C. Hetherington and Michael P. Dooley of the University of Virginia,[145] a court-ordered or court supervised buy-out was involved in only three of the cases,[146] whereas dissolution was ordered in sixteen of the twenty-seven cases in which some affirmative relief was granted.[147]

Two reasons probably account for the rather dramatic change in the mix between dissolution and buy-out cases in the two samples. First, a number of states have in recent years enacted statutes that allow the defendants to exercise a statutory buy-out right to purchase the shares of the plaintiff, thereby terminating the involuntary dissolution cause of action.[148] This statutory buy-out right was exercised in eight of the twenty buy-out cases in the 1984-1985 opinions. Six of these were from New York, which enacted this type of statute in 1979.[149] Second, courts in recent years seem to be increasingly willing to order a buy-out.[150] Perhaps this in turn reflects a greater willingness of courts to consider options other than dissolution or dismissal. Of the involuntary dissolution cases analyzed by Professor Hetherington and Dooley, no affirmative relief was granted in twenty-seven cases, and in eighteen of those cases, dissolution was either denied, or the complaint was dismissed.[151] Only four of the thirty-seven decisions on the merits in 1984 and 1985, however, resulted in no substantial relief being granted.[152]

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[145] Hetherington & Dooley, *Illiquidity And Exploitation: A Proposed Statutory Solution to the Remaining Close Corporation Problem*, 63 VA. L. REV. 1 (1976)[hereinafter Hetherington & Dooley].

[146] *Id.* App. I, cases 7, 8: App. II case 24, pp. 64-75.

[147] *Id.* App., Table II, pp. 70-75.

[148] *See supra* notes 112-27 and accompanying text.

[149] *In re* Cristo Bros., Inc., 64 N.Y.2d 975, 489 N.Y.S.2d 35, 478 N.E.2d 970 (1985); *In re* Levitt, 109 A.D.2d 502, 492 N.Y.S.2d 736 (1985); *In re* Gargano, 1120 A.D.2d 225, 491 N.Y.S.2d 440 (1985); Blake v. Blake Agency, Inc., 107 A.D. 139, 486 N.Y.S.2d 341 (1985); *In re* Fleischer, 107 A.D.2d 97, 486 N.Y.S.2d 272 (1985); *In re* Trocino, 126 Misc. 2d 304, 482 N.Y.S.2d 670 (1984). The other two cases are: Ronald v. 4-C's Electronic Packaging, Inc., 168 Cal. App. 290, 214 Cal. Rptr. 225 (1985); and Bricklin v. Stengol Corp., 1 Conn. App. 656, 476 A.2d 584 (1984).

[150] Actually, no court ordered a buy-out in any of the cases analyzed by Professors Hetherington & Dooley. All three of the buy-out cases were from states having the statutory buy-out format. In two of these cases, the plaintiff withdrew the complaint after the buy-out petition was filed. *See* Hetherington & Dooley, *supra* note 145 App. I, cases 7, 8; App. II case 24, pp. 64-75.

[151] *Id.*, App. I, pp. 64-69.

[152] These cases are discussed *infra* notes 235-54 and accompanying text.

Professors Hetherington and Dooley not only analyzed the judicial opinions issued between 1960 and the end of 1976, but they also followed up on each case to determine the ultimate outcome. Interestingly, out of all the cases, including those for which relief had been denied, fifty-four percent actually ended up with one side buying out the other.[153] This is exactly the same percentage as the buy-out cases in the 1984-1985 decisions. This parallelism suggests that recent decisions more accurately mirror the results ultimately negotiated by the parties than the decisions rendered a decade or more ago.[154]

Factually, the 1984-1985 involuntary dissolution cases present a fascinating tableau.[155] Roughly forty percent involved dissension in family-owned businesses. Many of the remaining sixty percent had more than one shareholder from a family, but were not controlled by a single family. Two of these cases[156] involved a dissatisfied divorced spouse

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[153] *See* Hetherington & Dooley, *supra* note 145, App. I and II, pp. 64-75.

[154] With respect to dissolution, ten of the thirty-seven cases in the 1984-1985 cases or twenty-seven percent resulted in an involuntary dissolution order whereas only nine out of fifty-four or seventeen percent of the corporations covered by the Hetherington and Dooley survey were actually liquidated. *Id.* at 31. Just because an involuntary dissolution order is issued does not mean that the corporation will be liquidated. Prior to liquidation, it could be sold to a third party or one or more of the shareholders could buy out the plaintiff's shares. This occurred in twelve of the seventeen cases in the Hetherington and Dooley survey where the court ordered dissolution. *See id.* App., Table II, at 70-75. Based on these figures, the percentage of corporations in the 1984-1985 sample used in this article that will actually be liquidated may be lower than the Hetherington and Dooley sample of 1960-1976 cases.

[155] The only major types of oppression not represented in the 1984 and 1985 involuntary dissolution cases are freeze-out mergers and other related squeeze-out techniques such as asset sales. *See* O'NEAL'S OPPRESSION OF MINORITY SHAREHOLDERS, *supra* note 1, §§ 5:04 - 5:08, 5:15 - 5:20. These cases are usually litigated as dissenters' rights cases; and damages can be awarded for self-dealing transactions and other breaches of fiduciary duty by the majority toward the minority shareholders arising out of the transaction. *See* Alpert v. 28 Williams St. Corp., 63 N.Y.2d 557, 483 N.Y.S.2d 667, 473 N.E.2d 19 (1984); Weinberger v. UOP, Inc., 457 A.2d 701 (Del. Sup. 1983). There is some authority, however, for challenging the transaction in an involutnary dissolution action. *See* Gabhart v. Gabhart, 267 Ind. 370, 370 N.E.2d 345, 352-56 (1977)(freeze-out merger with no business purpose can be treated as a *de facto* dissolution of the corporation). *But see* Jones v. Highway Inn, Inc., 424 So. 2d 944 (Fla. Dist. Ct. 1983)(dissenters' rights are exclusive, at least once the time period for filing dissenters' rights has expired). On the issue of the exclusivity of dissenter's rights, see Vorenberg, *Exclusiveness of the Dissenting Shareholders Appraisal Rights*, 77 HARV. L. REV. 1189 (1964). The possibility of an involuntary dissolution type claim even though dissenter's rights may be available is contemplated by the *MBCA Statutory Close Corporation Supplement. See MBCA Stat. Close Corp. Supp., supra* note 69, § 40(d)("If a shareholder has dissenters' rights . . . with respect to proposed corporate action, he must commence a proceeding under this section before he is required to give notice of his intent to demand payment . . . or the proceeding is barred"). The advantage of such a suit is the possibility of relief other than a monetary award.

[156] Stefano v. Coppock, 705 P.2d 443 (Alaska 1985); Bricklin v. Stengol Corp., 1 Conn. 656, 476 A.2d 584 (1984).

shareholder, an emerging category of case that will be explored in more detail later in this section.[157]

The family-controlled corporation cases are about what one would expect: father-child and sibling disputes, dissension that develops after a founding shareholder dies or retires, and divorce. Five of the cases[158] (thirty-three percent of the total) involved family farms, another emerging category.

The remaining cases present a broad range of factual situations that are difficult to categorize. The one consistent theme in most of these cases is that the dissension between the shareholders is deep-seated and protracted. This is particularly true with respect to the cases where dissolution was ordered. The behavior exhibited by one side or the other, and sometimes both sides, can in many cases only be described as egregious and incredible, proving once again the wisdom of the old adage that "truth is stranger than fiction."

A court-ordered or court-supervised buy-out was more prevalent in the family-controlled corporation cases than in the remaining cases (sixty-seven percent vs. forty-one percent). The family-controlled corporation cases also had a lesser percentage of dissolution orders (twenty percent vs. thirty-two percent) and fewer cases where no relief was granted (one out of fifteen vs. three out of twenty-two). These statistics are not really surprising, however.

The analysis of the 1984-1985 cases becomes more interesting when they are examined in more detail. For this purpose, the cases will be divided between those where dissolution was ordered and those where relief other than dissolution, or no relief, was granted.

B. *The Dissolution Cases*

As a general rule, courts have ordered dissolution in two types of situations: (1) protracted deadlock that stems from irreconcilable policy or personal differences between the shareholders; and (2) high-handed, overreaching egregious conduct by a dominating shareholder. The 1984 and 1985 cases contain illustrations of both types.

Leck v. Pugh[159] is a classical case of protracted deadlock. Leck and Pugh formed a Texas corporation in 1972. Each owned fifty percent of the shares. Almost from the inception of the business they engaged in

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[157] *See infra* notes 224-34 and accompanying text.

[158] Sauer v. Moffitt, 363 N.W.2d 269 (Iowa Ct. App. 1984); Maddox v. Norman, 697 P.2d 1368 (Mont. 1985); Lowder v. All Star Mills, Inc., 75 N.C. App. 233, 330 S.E.2d 649 (1985); Gimpel v. Bolstein, 125 Misc. 2d 45, 477 N.Y.S.2d 1014 (1984); Ward v. Ward Farms, Inc., 283 S.C. 568, 324 S.E.2d 63 (1984). One of the non-family cases also involved a farm corporation. *See* Gillingham v. Swan Falls Land & Cattle Co., 106 Idaho 859, 683 P.2d 895 (1984).

[159] 676 S.W.2d 180 (Tex. Civ. App. 1984).

continual litigation against each other. Finally, in 1979, a custodial receiver was appointed, but he was unable after several years to come up with a feasible plan to remedy the differences between the co-owners. The Texas Court of Appeals upheld the trial court's involuntary dissolution order, stating that "[t]he parties are irrevocably at odds with no reasonable chance for any change."[160]

In re T.J. Ronan Paint Company,[161] a New York case, combines both protracted deadlock and high-handed behavior. The two principal shareholders, Lennon and Doran, who individually and through their respective families each controlled fifty percent of the corporation's stock, had management disagreements beginning in the mid-1970's which intensified in 1976 when Lennon sued Duran for fraud, conversion, and waste. This set off four years of corporate warfare during which time Lennon allegedly physically assaulted Doran, cut off his salary, and locked him out of the corporate offices. In spite of this turmoil, the corporation was financially successful. In 1980 a custodial receiver was appointed. The judge who appointed the receiver remarked in his opinion that "the two principals had consumed more time in litigating claims involving this corporation than any other group of litigants in the court's experience."[162] This particular opinion, issued in 1984 by the Appellate Division of the New York Supreme Court, dealt with a number of issues relating to the receivership, which at the time of the appeal had lasted three and one-half years. The court ordered the corporation to be dissolved immediately by public sale of assets unless Lennon and Duran could agree on a private sale within thirty days. In the course of the opinion the court observed that:

> The degree of dissension, reflected by the intense personal hostility, poses an irreconcilable barrier to the continued functioning and prosperity of the corporation, a hopeless deadlock which mandates dissolution as the only viable remedy.[163]

Another somewhat similar combination of deadlock and overreaching is *Mordka v. Mordka Enterprises, Inc.*,[164] which involved a financially successful real estate corporation owned by three brothers. In June 1979 one of the brothers, Irwin, who had moved back to Arizona from New

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[160] *Id.* at 181. *See also* Burnett v. Chase Oil & Gas, Inc., 700 S.W.2d 737 (Tex. Civ. App. 1985)(after eighteen months the custodial receiver recommended liquidation of a two-man deadlocked corporation); Gillingham v. Swan Falls Land & Cattle Co., 106 Idaho 859, 683 P.2d 895 (1984)(irreconcilable differences over proper use of a small farm equally owned by the widows of the two founding shareholders).

[161] 98 A.D.2d 413, 469 N.Y.S.2d 931 (1984).

[162] *Id.* at 415, 469 N.Y.S.2d at 933.

[163] *Id.* at 421, 469 N.Y.S.2d at 936.

[164] 143 Ariz. 298, 693 P.2d 953 (Ariz. Ct. App. 1984).

Zealand five months earlier at the request of the other two brothers, was fired from the corporation, and his salary was terminated. The corporation paid no dividends. After the freeze-out the two brothers who were active in the business raised their own salaries, bought and sold property, and took other action in clear violation of a bylaw that required unanimous consent of all three brothers for major decisions. This bylaw had been agreed to at the insistence of Irwin at the time the three brothers acquired a controlling block of stock from their mother. The trial court ordered the corporation dissolved on the grounds that a technical deadlock existed because of the unanimous consent bylaw. The appellants unsuccessfully argued on appeal that the unanimous consent bylaw was unenforceable. They also contended that it was improper to order involuntary dissolution of a profitable corporation. The Arizona Court of Appeals rejected this argument stating that profitability is not the "sole criterion."[165] The court further held that the Arizona involuntary dissolution statute requires "only that irreparable injury is threatened by reason of the deadlock"[166] and that if the unanimous consent bylaw was enforced, the corporation would be unable to borrow money or exercise options without Irwin's consent, which presumably he would refuse to give, thereby presenting a sufficient threat of irreparable injury.

Mordka represents an enlightened, liberal view of what constitutes a deadlock.[167] In many other states, this case might have been classified as a freeze-out oppression case. The only ground for involuntary dissolution of a corporation other than an electing statutory close corporation in Arizona, however, is deadlock.[168] Therefore, *Mordka* can logically be viewed as an illustration of a court's willingness to stretch traditional statutory construction principles to reach a desired result.

Goben v. Barry[169] illustrates judicial inventiveness of a different kind. In 1978 Goben and Barry organized a corporation to sell oil and gas drilling interests pursuant to an oral agreement under which they were each to own fifty percent of the stock, share profits and losses equally, and draw equal salaries. No stock was apparently issued at the time the corporation was formed, however. This joint venture was financially successful from its inception, perhaps too successful. Several months after the corporation began business, Barry, without Goben's knowledge or consent, increased his weekly salary from $560 to $1,700. Shortly

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[165] *Id.* at 305, 693 P.2d at 960.

[166] *Id.* at 305, 693 P.2d at 960.

[167] *See supra* notes 33-38 and accompanying text.

[168] *See* ARIZ. REV. STAT. ANN. § 10-097 (1977). The involuntary dissolution statute applicable to electing close corporations uses the somewhat broader term "deadlock or dispute." *Id.* § 10-215(b). *Cf.* King v. Coulter, 113 Ariz. 245, 550 P.2d 623 (1976)(court denied relief based on oppression theory in case involving excessive salaries and bonuses and no dividends because of absence of statutory authority).

[169] 234 Kan. 721, 676 P.2d 90 (1984).

thereafter, when Goben asked to see the check register, Barry became quite belligerent and tried to badger Goben into selling his interest to him for $10,000. Goben refused this ultimatum. Barry then proceeded to cut off Goben's salary, have Goben's personal belongings in the corporation's office removed to a storage warehouse, and repossess an automobile that had been purchased by the corporation for Goben's use. He also issued shares representing fifty percent of the stock to his wife and during the four years preceding the trial of this case authorized salaries to himself and his wife that averaged about $125,000 per year.

Given the factual situation, it is not surprising that the Arizona Court of Appeals affirmed the trial court's decision that the corporation be dissolved and also affirmed a punitive damage judgment of $82,237 against Barry. The interesting aspects of this decision are the court's willingness to enforce the oral agreement between Goben and Barry and the innovative fashion in which the court framed its order of relief. Reversing the trial judge's ruling that Goben was only entitled to his share of the profits up until the date Barry froze him out of the corporation, the Arizona Court of Appeals held that Goben was entitled to one-half of the net profits from the inception of the business until it was formally dissolved. The court also held that Goben was entitled to one-half the net assets upon liquidation and prejudgment interest on the amount of salary paid to Barry and his wife in excess of the amount paid to Goben plus a reasonable salary for the services performed for the corporation by Barry's wife.[170] In effect the court treated the corporation as if it were a partnership and gave Goben essentially the same rights as he would have under the Uniform Partnership Act.[171]

Another interesting dissolution case in the two-year sample used for this article is *Lowder v. All Star Mills, Inc.*,[172] which involved six interrelated family corporations that engaged in various farming operations in North Carolina. All Star Mills, Inc., the original corporation, had been formed in 1934 by W.A. Lowder. The other corporations were formed in the 1950s and 1960s. All the corporations were owned in varying percentages by the children and grandchildren of W.A. Lowder and their spouses. The two principal protaganists were Horace Lowder, who since W.A. Lowder's death in 1970 had assumed complete control and domination of all the corporations, and his brother, Malcolm, who worked over the years as an executive in several of the corporations. Malcolm began taking an active interest in the businesses in the mid-1970s following Horace's criminal conviction for income tax evasion. In 1978 Malcolm demanded full access to the books and records of all the corporations.

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[170] *Id.* at 731, 676 P.2d at 99.

[171] *See* Unif. Partnership Act §§ 38-42 (1914). *See also supra* note 96 and accompanying text.

[172] 75 N.C. App. 233, 330 S.E.2d 649 (1985).

Horace refused this request, but he did give Malcolm income statements and balance sheets for the previous ten years. Then, three days after Malcolm's demand, Horace issued additional shares to himself giving him absolute control in All Star Mills, Inc. At that point, All Star Mills, Inc. was a holding company which leased property to businesses controlled by Horace and which owned stock in some of the other corporations in the group. Malcolm then filed this lawsuit and Horace retaliated by firing him from his employment with one of the corporations.

Two types of relief were granted by the trial court and affirmed by the North Carolina Court of Appeals. First, a constructive trust was placed on the assets of three of the corporations controlled by Horace under the corporate opportunity doctrine on the grounds that many of the assets used in the formation and operation of these corporations were wrongfully diverted from All Star Mills, Inc. Under this part of the judgment, All Star Mills, Inc. was to receive the assets of these three corporations after payment of outstanding liabilities and repayment of investments "properly proven."[173] Second, the remaining three corporations were ordered to be dissolved on two grounds: one, that Horace's actions improperly frustrated the reasonable expectations of Malcolm and the other shareholders who were in agreement with Malcolm's position and two, that dissolution was the only way the plaintiffs could realize their reasonable expectations.[174] In the course of the opinion, the court, which adopted the rationale of the 1983 North Carolina Supreme Court case of *Meiselman v. Meiselman*,[175] stated:

> Among the rights and interest that the Court in *Meiselman* said that a shareholder has in a close corporation are secure employment, fringe benefits which flow from his association with the corporation, and meaningful participation in the management of the family business, in addition to the traditional shareholder rights, such as the right to notice of stockholders' meetings, the right to vote cumulatively, the right of access to the corporate offices and to corporate financial information, and the right to compel the payment of dividends. In the present case, the superior court found and concluded that plaintiffs, as shareholders of All Star Mills, had reasonable expectations that the companies would be managed by the controlling officer in accordance with his fiduciary obligations and according to law; that the plaintiffs'

[173] *Id.* at 242, 330 S.E.2d 655.

[174] North Carolina has an unusual statute that authorizes involuntary dissolution when it is "reasonably necessary for the protection of the rights and interests of the complaining shareholder." N.C. GEN. STAT. § 55-125(a)(4)(1982). This language has been interpreted as encompassing the reasonable expectations doctrine. *See* Meiselman v. Meiselman, 309 N.C. 279, 307 S.E.2d 551 (1983).

[175] 309 N.C. 279, 307 S.E.2d 551 (1983).

> equity in the corporation would not be diluted by the usurpation of corporation opportunities or the diversion of corporate assets to other companies; and that plaintiffs would have a reasonable opportunity to realize on the value of their equity in the companies. The court further found and concluded that plaintiff Malcolm Lowder, as a shareholder of Mills, Farms and Consolidated, had a reasonable expectation that he would have 'continued employment and a position and compensation reasonably proportionate to his ownership in the companies, and his training and experience'; and that plaintiffs' reasonable expectations were frustrated, through no fault of theirs, because as the jury determined, Horace Lowder misappropriated corporate opportunities of All Star Mills. As further support of its decision to liquidate the corporations, the superior court cited Horace Lowder's exercise of complete control and domination of the corporations since his father's death in 1970, his refusal to allow Malcolm Lowder a position of more authority or participation after their father's death, his handling of tax claims against the companies without counsel, his management of the companies without consulting other shareholders, his direction of operations toward companies in which he had larger interests, and his issuance of treasury stock to himself without consulting other shareholders. Noting that the other shareholders had exhibited animosity towards Malcolm Lowder during this litigation, had aligned themselves with Horace Lowder in this litigation, and had adopted a corporate resolution requiring the Board of Directors to return to Horace Lowder any assets lost by him as a result of the litigation, the Court found and concluded that the majority of the stockholders would align themselves in opposition to plaintiff in any future operation of the corporations and that it would be difficult, if not impossible, for the affairs of the companies to be conducted in such a way that plaintiff might realize his reasonable expectations. The court concluded that the only way plaintiff's reasonable expectations could be protected was through the liquidation and dissolution of Farms and Consolidated.[176]

The *Lowder* case is one of several cases in 1984 and 1985 that utilized the reasonable expectations doctrine.[177] It is also significant because of the manner in which the court treated all six of the corporations as a unit for analytical purposes and even though the complaint contained multi-

[176] 75 N.C. App. at 243-44, 330 S.E.2d at 656.

[177] *See, e.g.*, Stafano v. Coppock, 705 P.2d 443 (Alaska 1985); *In re* Kemp & Beatley, Inc., 64 N.Y.2d 63, 484 N.Y.S.2d 799, 473 N.E. 1173 (1984).

ple causes of action, fashioned a single order that provided appropriate and total relief for all of the wrongs committed by Horace Lowder.[178]

The final case in which involuntary dissolution was ordered that merits discussion is the English case of *In re Zinotty Properties, Ltd.*,[179] a corporation formed in 1967 to develop a tract of real estate. Zinotty Properties Ltd. was owned by two other corporations. One, which owned twenty-five percent of the shares, was controlled by Leslie Brown. The other, which owned seventy-five percent of the stock, was controlled by Albert Perry and Robert Bulfield. Brown and Perry had previously conducted other similar joint ventures on a twenty-five—seventy-five percent basis. Bulfield had not been involved in the other corporations, however.

Without Brown's knowledge, cash generated from the original development was used to purchase another tract of land. In 1974 Brown complained about this purchase and the fact that contrary to his understanding of the agreement made when the corporation was formed, he had never been made a director of Zinotty. In spite of these protests, Perry and Bulfield continued to run Zinotty as they saw fit. By the end of 1980 they had caused Zinotty to loan various businesses they controlled in excess of £233,000. The amount of interest on these loans, if any, was unclear from Zinotty's financial records, which were handled by an accounting firm in which Bulfield was a partner.

In December 1982 the corporation controlled by Brown filed suit to have Zinotty involuntarily dissolved under § 222 of The Companies Act.[180] Then in January 1983, Perry and Bulfield contrived to call a special shareholders meeting of the Board of Directors for the purpose of placing Zinotty in voluntary receivership and to name another accountant in Bulfield's accounting firm as the liquidating receiver. Brown objected to this procedure by letter and did not attend the shareholders meeting on the assumption that since there were only two shareholders, there could be no quorum in his absence. Prior to the meeting, however, one share of stock in Zinotty was transferred to Bulfield personally. Perry and Bulfield attended the shareholders meeting, declared a quorum, and, controlling seventy-five percent of the shares, approved the voluntary dissolution.

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[178] Actually, that part of the opinion granting a constructive trust on the assets of three of the corporations because of a wrongful usurpation of corporate assets by Horace Lowder will result in those three corporations being liquidated. *See* 75 N.C. App. at 240-42, 330 S.E.2d at 654-55. Thus, ultimately all six corporations were ordered to be involuntarily dissolved, although two different legal theories were used to reach this result.

[179] [1984] 3 All E.R. 754 (Ch. Div.).

[180] *English Companies Act* 1948, § 222. A petition for alternative relief under § 75 of the *English Companies Act* of 1980 was abandoned. The interrelationship between §§ 222 and 75 (formerly § 210 of the 1948 English Companies Act) is explored in O'NEAL'S OPPRESSION OF MINORITY SHAREHOLDERS, *supra* note 1, §§ 10:11-10:13.

The Chancery Court held that the transfer of stock to Bulfield was probably illegal;[181] but even if it was proper, because of the overreaching conduct by Perry and Bulfield and the conflict of interest created by the involvement of Bulfield's accounting firm, the liquidation of Zinotty must proceed as an involuntary dissolution.

This case illustrates two interesting points. First, the court, apparently with the consent of the attorneys for both sides, pierced the corporate veil of the two corporations that owned Zinotty and viewed this case as one involving three individuals engaged in a quasi-partnership corporation. The piercing was legally necessary in order to bring the case within the ambit of the 1972 decision of *Ebrahimi v. Westbourne Galleries, Ltd.*,[182] which was the first major case to adopt the reasonable expectations doctrine.[183] Second, *Zinotty* stands for the proposition that a voluntary dissolution can be oppressive to the minority, thereby justifying equitable intervention by a court. There is also American case law precedent for this proposition.[184]

C. *Relief Other Than Dissolution*

The principal differences between the cases in which involuntary dissolution was ordered and those in which some other relief was granted are: (1) the trial court's discretionary decision that relief other than dissolution was appropriate under the circumstances and the upholding of that decision on appeal under the narrow abuse of discretion rule; and (2) the degree to which the plaintiff's conduct caused or exacerbated the dissension that led to the suit. The absence of punitive or overreaching conduct against a minority shareholder by the controlling shareholders was also an important factor in many of the cases.

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[181] Stock issues engineered by majority shareholders were declared illegal in three other 1984-85 involuntary dissolution cases: Bricklin v. Stengol Corp., 1 Conn. App. 656, 476 A.2d 584 (1984); Valerino v. Little, 62 Md. App. 588, 490 A.2d 756 (1985); *In re* Rappaport, 110 A.D.2d 639, 487 N.Y.S.2d 376 (1985).

[182] [1972] 2 All E.R. 492 (H.L.).

[183] American courts have shown a willingness to pierce the croporate veil and to treat interrelated corporations as a single writ in somewhat similar circumstances involving oppressive conduct. *See* Lowder v. All Star Mills, Inc., 75 N.C. App. 233, 330 S.E.2d 649 (1985), discussed *supra* notes 172-76 and accompanying text; *In re* Dubonnet Scarfs, 105 A.D.2d 339, 484 N.Y.S.2d 541 (1985), discussed *infra* notes 235-38 and accompanying text. *See also* Belcher v. Birmingham Trust Nat'l Bank, 348 F. Supp. 61 (N.D. Ala. 1968); Hill v. Bellevue Gardens, Inc., 190 F. Supp. 760 (D. C. Dist. Col. 1960), *aff'd*, 297 F.2d 185 (D.C. App. 1961); Fortunge v. Hudson Manure Co., 51 N.J. Super. 482, 144 A.2d 297 (1958); Prince v. Sonnesyn, 222 Minn. 528, 25 N.W.2d 468 (1946).

[184] *See* Kirtz v. Grossman, 463 S.W.2d 541 (Mo. App. 1971); Levy v. Billeand, 443 So. 2d 539 (La. 1983). *See also In re* Widey's Furniture Clearance Center, Inc., 108 A.D.2d 81, 487 N.Y.S.2d 901 (1985)(injunction issued against attempted voluntary dissolution commenced after involuntary dissolution suit filed). *Cf.* Schraft v. Leis, 238 Kan. 28, 686 P.2d 865 (1984). *See generally* O'NEAL'S OPPRESSION OF MINORITY SHAREHOLDERS, *supra* note 1, § 5:21.

Three cases decided in 1984 and 1985 involving family animosity illustrate these points. The first is *Sauer v. Moffitt*,[185] which like *Lowder v. All Star Mills, Inc.*,[186] discussed in the preceding subsection,[187] involved a series of family-owned farming operations. Prior to 1964 Maurice Moffitt owned three farms. In 1964 he gave one of them to his two daughters, Martha and Kathy. In 1967 he formed the Moffitt Corporation. His two farms plus the farm given to Martha and Kathy were transferred to the corporation in return for stock. Maurice's wife and two sons also received stock in Moffitt Corporation. According to Martha and Kathy, Maurice had orally promised them that all four children would receive an equal number of shares at the time of incorporation and that any future gifts or devises of stock in Moffitt Corporation by Maurice and his wife would also be equal. Nevertheless, the two sons each received seven more shares than Martha and Kathy. When questioned about this, Maurice said that the sons were operating the farms and for that reason needed to be able to out-vote their sisters. In addition, between 1967 and 1980, when this suit was tried, Maurice and his wife made other gifts of Moffitt corporation stock to all four children, but had given more stock to the two sons. The differential had increased from seven to seventy-three shares by 1980.

Conflict developed after Martha and Kathy in 1971 moved back to Iowa from Oklahoma where they had lived for several years and, needing money, demanded that dividends be paid. This demand was ignored and finally in 1978 Martha and Kathy filed suit, requesting various types of relief including involuntary dissolution. The evidence showed that Moffitt Corporation leased its farms to Maurice on a fifty-fifty sharecrop basis but that some of Moffitt's share of the crops and money was improperly diverted to Maurice directly and to other separate farming operations conducted by Maurice and his sons. Tracing the degree of impropriety was difficult because Moffitt's financial records were not kept properly or accurately.

The trial court ruled that the oral agreement with respect to the allocation of stock among the children was enforceable[188] and ordered Maurice and his wife to convey sixty-six shares of Moffitt stock to Martha and Kathy. After this transfer, Martha and Kathy would own seven fewer shares than their brothers, the same differential that existed at the time Moffitt Corporation was formed.

The trial court also ordered Moffitt Corporation to redeem all the stock

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[185] 363 N.W.2d 269 (Iowa App. 1984).

[186] 75 N.C. App. 233, 330 S.E.2d 649 (1985).

[187] *See supra* notes 172-78 and accompanying text.

[188] The willingness of courts to enforce oral agreements between close corporation shareholders will be an increasingly important factor in the development of the reasonable expectations doctrine. *See infra* note 289.

owned by Martha and Kathy at its fair value, determined to be $135,893.06, with interest from the date the suit was brought. The court ordered a partial liquidation, and although it is not clear from the opinion, apparently land or other assets of Moffitt Corporation were to be used to pay for this stock.[189]

In addition, reparation for improper expenditures from Moffitt Corporation was also ordered; and punitive damages in an unspecified amount were awarded to Martha and Kathy. Finally, the trial court awarded $20,000 in attorneys' fees to Martha and Kathy. They had submitted a request for $80,000 of attorneys' fees. The trial court, however, rejected a claim that a constructive trust should be imposed on other farms owned by Maurice and one of the sons, holding that the evidence did not indicate Moffitt Corporation had any reasonable expectancy in them.

The Iowa Court of Appeals affirmed the trial court's order with minor modifications. The Court of Appeals held that the trial court could have ordered involuntary dissolution under the circumstances but had the discretion to fashion other equitable relief, and "[t]he district court order requiring a partial liquidation and redemption of the plaintiffs' shares provides appropriate equitable relief for both their individual claims of fraud and derivative claims . . . ."[190] In addition, the Court of Appeals upheld the punitive damage award on the grounds that the defendants' actions in commingling and wrongfully diverting Moffitt Corporation's assets were clear breaches of fiduciary duty that "rose to the level of intentional acts of fraud."[191] The attorneys' fee award was also upheld on the grounds that even though attorneys' fees could only be recovered for the derivative cause of action, the derivative claim was only one of five causes of action filed in the complaint.[192]

The two additional family dissension cases are from New York. The first is *In re Wiedy's Furniture Clearance Center Co., Inc.*,[193] another case

[189] Another 1984-85 case in which corporate land was distributed to a minority shareholder in a court ordered partial liquidation is Maddox v. Norman, 697 P.2d 1368 (Mont. 1985). *Maddox* also involved a family farm corporation. Partial liquidations have also beeen ordered in other cases. *See* Belcher v. Birmingham Trust Nat'l Bank, 348 F. Supp. 61, 147-53 (N.D. Ala. 1968). Recent tax legislation amending Section 311 of the Internal Revenue Code has eliminated the circumstances in which a corporation can distribute land or other assets to a shareholder in a partial liquidation without having to pay a tax on any built-in gain on the distributed property. For this reason courts should as general rule refrain from directing that specific property be distributed to a shareholder. The corporation can be directed to repurchase the stock; but the method of financing that purchase should, except in very unusual cases, be left to the discretion of management.

[190] 363 N.W.2d 269, 275 (Iowa App. 1984).

[191] *Id.*

[192] The reluctance of courts to award attorneys' fees to successful plaintiffs in involuntary dissolution suits is discussed *supra* notes 97-100 and accompanying text and *infra* note 276 and accompanying text.

[193] 108 A.D.2d 81, 487 N.Y.S.2d 901 (1985).

involving multiple family-owned corporations. Edward Wiederspeil, together with his wife and two sons, Edward III and Bruce, owned five corporations that engaged in the furniture business. Bruce, who was the plaintiff, owned one-third of the shares of Wiedy's Furniture Clearance Center Co., Inc. and modest amounts of stock in some of the other family corporations. Bruce had worked for one or more of the corporations for most of his adult life, except for approximately a year when he moved to Florida.

Wiedy's Furniture Clearance Center was formed at the time he returned from Florida. Bruce managed this business from his return in 1974 until he was fired by his father in July, 1983 following a dispute over the hiring of an employee. His father also discharged Bruce as an employee and officer of all the family corporations, changed the locks on Wiedy's Furniture Clearance Center, threatened Bruce with criminal prosecution if he attempted to come onto any of the corporate properties, and published a newspaper notice stating that Bruce was no longer associated with the family businesses.

Bruce filed suit seeking involuntary dissolution of Wiedy's Furniture Clearance Center and the other four corporations and also obtained a temporary injunction prohibiting the attempted voluntary dissolution of Wiedy's Furniture Clearance Center.

As a preliminary matter, the petition for dissolution of the corporations other than Wiedy's Furniture Clearance Center was dismissed on jurisdictional grounds. Section 1104-a of the New York Business Corporation Law[194] requires a shareholder to own a minimum of twenty percent of the outstanding stock in order to seek dissolution under this statute. Bruce could only meet this requirement with respect to Wiedy's Furniture Clearance Center.[195] This ruling illustrates the practical problems created by a minimum ownership requirement which New York and several other states impose.[196]

Proceeding to the merits of Bruce's claim, the trial court held that the freeze-out of Bruce constituted oppression under the reasonable expecta-

[194] N.Y. Bus. Corp. Law § 1104-a (McKinney 1986).

[195] The court also ruled that even if all of the corporations were treated as a single unit, Bruce would not own the requisite 20 percent in the aggregate. In fact, if the single entity argument made by the plaintiff had been accepted by the court, the case would have been dismissed in its entirety. *See* 108 A.D.2d at 81, 487 N.Y.S.2d at 901 (1985).

[196] *See supra* notes 62-64 and accompanying text. New York has a line of cases that authorize a common law suit for involuntary dissolution, which presumably could be invoked in a subsequent suit for involuntary dissolution involving the other four family corporations. *See* Leibert v. Clapp, 13 N.Y.2d 313, 196 N.E.2d 540, 247 N.Y.S.2d 102 (1963); Lewis v. Jones, 107 A.D.2d 931, 483 N.Y.S.2d 868 (1985); *In re* DuBonnett Scarfs, Inc., 105 A.D.2d 339, 484 N.Y.S.2d 541 (1985). Apparently neither Bruce's attorney nor the trial judge was aware of these cases.

tions doctrine and ordered that Bruce's shares in Wiedy's Furniture Clearance Center be purchased at their fair value.

This order was affirmed on appeal. The Appellate Division of the New York Supreme Court pointed out in its opinion that Bruce had a reasonable expectation of continuous employment in the family businesses and that Wiedy's Furniture Clearance Center had been quite profitable under his management.[197] The appeals court also held that the appropriate remedy for minority shareholder oppression is within the sound discretion of the trial judge.[198] The appeals court further pointed out that the applicable involuntary dissolution statute requires a court to consider whether liquidation is the only feasible means of protecting the plaintiff's interests;[199] and that in this particular case, the amount received on liquidation, which would be one-third of the net assets of Wiedy's Furniture Clearance Center, might well be less than the amount received for his stock under the court ordered buy-out.[200] Moreover, Bruce's father and other family members could always subsequently decide to liquidate Wiedy's Furniture Clearance Center if they wished to do so.

The other New York case is *Gimpel v. Bolstein*,[201] which involved a dispute between third generation shareholders in a family-owned dairy farm corporation. All members of the family actively participated in the dairy operations and were paid on a salary basis. No dividends had ever been paid; but non-voting stock had been issued to some of the shareholders and was periodically redeemed as part of an overall family estate plan.

Robert Gimpel, who owned both voting and non-voting stock, was

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[197] 108 A.D.2d at 84, 487 N.Y.S.2d at 903-04.

[198] 108 A.D.2d at 84, 487 N.Y.S.2d at 904.

[199] N.Y. BUS. CORP. LAW § 1104-a(b)(McKinney 1986) states:

> The court, in determining whether to proceed with involuntary dissolution pursuant to this section, 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; and (2) Whether liquidation of the corporation is reasonably necessary for the protection of the rights and interests of any substantial number of shareholders or the petitioner.

[200] The difference could be substantial since the buy-out price would presumably include the going concern goodwill value of the corporation. *See supra* notes 80-83 and accompanying text. Moreover, in many circumstances, the price received for business assets in a forced liquidation sale is considerably less than the inherent fair market value of those same assets. This is particularly true with respect to inventory, which was apparently the main type of asset held by Wiedy's Furniture Clearance Center. An additional danger of a liquidation in this case is that Bruce's father or the other corporations he controleed are the most likely purchasers of the assets. If this occurs, the court ordered liquidation results in an unintended benefit to the wrongdoing shareholders. This possibility has been a factor in other decisions refusing to order an involuntary dissolution. *See supra* note note 28.

[201] 125 Misc.2d 45, 477 N.Y.S.2d 1014 (1984).

employed as an executive with the corporation until 1974 when he was discharged after being accused of embezzling $85,000. He subsequently filed this action seeking to have the corporation involuntarily dissolved, claiming oppression because he received no income from the corporation and had been denied access to the corporation's books and records. He also claimed that other shareholders were being paid excessive salaries, that proper stock certificates had not been issued to him and that the corporation failed to hold shareholders' meetings.

The New York Supreme Court held that Robert was not the victim of oppression, whether that term is defined as frustration of reasonable expectations or breach of fiduciary duty. As to the former definition, the court stated:

> the only expectations he could reasonably entertain were those of a discovered thief: ostracism and prosecution. To the extent the majority has refrained from prosecuting him, they have dealt with him more kindly than he had reason to expect not less.[202]

As to the second definition, the court said:

> [i]t 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 Robert 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.[203]

The court further held that the failure to issue stock certificates, to hold shareholders' meetings or to allow Robert access to the corporate records were wrongful but "[did] not, individually or collectively, constitute oppressive conduct such as would justify dissolution."[204] Moreover, the court held that the allegations of excessive salaries could be determined in a separate derivative action, and therefore, even if true, did not merit dissolution.

The absence of any income on Robert's stock, however, presented a more troublesome issue. The court observed:

> [e]ven Cain was granted protection from the perpetual vengefulness of his fellow man. (Genesis 4:12-15). While his past misdeeds provided sufficient justification for the majority's acts to date, there is a limit to what he can be forced to bear, and that limit has been reached. The other shareholders need not allow him to

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[202] *Id.* at 52, 477 N.Y.S.2d at 1020.
[203] *Id.* at 53, 477 N.Y.S.2d at 1020.
[204] *Id.* at 54, 477 N.Y.S.2d at 1021.

return to employment with the corporation, but they must by some means allow him to share in the profits.[205]

The relief granted by the court is the most interesting aspect of this case. In addition to mandating that Robert be given full access to the corporation's books and records, the court ruled that the majority shareholders had six months to elect either to commence paying "substantial (consistent with sound business judgment)"[206] dividends or to make a good faith offer to purchase Robert's shares. The court pointed out that in determining the reasonableness of any dividends, the amount of salaries paid to the remaining shareholders that in fact represented dividends would have to be taken into account. In addition, the court recognized that if the dividend option was chosen, changes in the corporation's capital structure might have to be made because of the non-voting stock redemption plan that had been in effect for so many years.[207] The court said that "if any changes are made, they must be made in good faith, for a legitimate business purpose, and not for the purpose of weakening Robert's position."[208] To assure compliance with its directives, the court issued its order as a mandatory injunction and specified that dissolution could be one of the remedies for contempt.

The flexibility incorporated into this innovative order is quite remarkable.[209] The corporation's remaining shareholders were given realistic

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[205] *Id.* at 55, 477 N.Y.S.2d at 1021.

[206] *Id.* at 56, 477 N.Y.S.2d at 1022.

[207] One reason why it might have been desirable to change the corporation's capitalization was that a provision in the existing articles of incorporation required that equal dividends be paid on both voting and non-voting shares. Limiting the dividends only to voting stock or differentiating in the amount of dividends payable on the voting and non-voting stock would lessen the overall cost of the dividend policy and still preserve the estate planning objective that the non-voting stock was intended to achieve. The trial judge's sensitivity to this and other corporate planning objectives is commendable. *See* 125 Misc. 2d at 56-57, 477 N.Y.S.2d at 1020, 1022.

[208] *Id.* at 57, 477 N.Y.S.2d at 1022.

[209] Other judges have also issued innovative orders in involuntary dissolution cases. *See, e.g.*, Belisle v. Colebrook Water Co., 110 N.H. 17, 259 A.2d 131 (1969)(order required that the corporation either redeem preferred shares for their par value plus accrued but unapid dividends or pay the court ordered fair value of the shares); Rytkonen v. Butler, 305 Mich. 580, 9 N.W.2d 849 (1943)(an assignment of a lease to a majority shareholder ordered cancelled; the leased property belonged to a minority shareholder); Kisner v. Coffey, 418 So. 2d 58 (Miss. 1982)(deferred compensation required to be equalized); Handlan v. Handlan, 232 232 S.W.2d 944 (Mo. 1950)(corporation dissolved unless plaintiff purchased the defendant's shares or *vice versa*; accounting ordered for questionable expenses such as payment of shareholder's club dues and liquor); Browning v. C&C Plywood Corp., 248 Or. 574, 434 P.2d 339 (1967)(as relief for a pre-emptive rights offering squeeze-out engineered by the majority shareholders, the appellate court, in reversing an order of involuntary dissolution, suggested that the lower court on remand consider either cancelling the shares issued in the rights offering or allow the plaintiff to purchase additional shares at the same price as the majority up to the amount necessary to restore his previous percentage of equity

options, and the court retained jurisdiction of the case to see that both sides used good faith. The court's willingness to grant some relief to Robert even though he was the principal wrongdoer is also innovative. A shareholder in a closely-held corporation should at a minimum be entitled to some dividends or other return on investment if all the other shareholders are obtaining distribution from the corporation in the form of salary.[210]

The relative degree of fault among the contending shareholders can be a significant factor in the outcome of a particular case. The contrast between *Gimpel v. Bolstein* and *In re Kemp & Beatley*,[211] a 1984 decision from the New York Court of Appeals, illustrates this point. Just before or shortly after two long-time executives left Kemp & Beatley, the corporation changed its compensation policy. Before the change, the corporation paid out profits in the form of bonuses based on the percentage of stock held by each shareholder. After the change, only salaried employees received the bonuses. Since Kemp & Beatley paid no dividends, the two former employees, who together owned slightly over twenty percent of the stock, received no income from the corporation after they ceased to be employees.

The trial court gave Kemp & Beatley a choice: it could either buy out the plaintiffs' shares at their fair value or be dissolved. This decision was upheld on two grounds by the New York Court of Appeals, which used the case as an opportunity to adopt the reasonable expectations theory of oppression:[212] (1) the trial judge has broad discretion to fashion the appropriate remedy;[213] and (2) once a prima facie case of oppression is

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with the cost being an offset against unpaid back salary owed to the plaintiff); *In re* Schramm, 107 Misc. 2d 393, 434 N.Y.S.2d 333 (1980)(eviction consent order agreed to by fifty percent shareholder of a restaurant corporation after an involuntary dissolution suit was filed set aside; if not, the restaurant would have been out of business); ARC Mfg. Co., Inc. v. Konrad, 467 A.2d 1133 (Pa. Super. 1983)(custodian appointed to remedy high-handed behavior by the majority including changing locks, exclusion from access to coroporate records, termination of salary and eligibility for pension and profit sharing plan, and increase in salaries of remaining shareholders; no error, however, in refusing to order plaintiff rehired due to the animosity between the shareholders). *See also* Goben v. Barry, 234 Kan. 721, 676 P.2d 90 (1984), discussed *supra* notes 169-71 and accompanying text.

[210] Other courts have ordered dividends to be paid to minority shareholders who have been improperly squeezed out in somewhat more appealing factual circumstance than existed in Gimpel v. Bolstein. *See* Patton v. Nicholas, 154 Tex. 385, 279 S.W.2d 848 (1955); *id.*, 302 S.W.2d 441 (Tex. Civ. App. 1957); Erdman v. Yolles, 62 Mich. App. 594, 233 N.W.2d 667 (1975); Miller v. Magline, Inc., 76 Mich. App. 284, 256 N.W.2d 761 (1977). *See also* Smith v. Atlantic Properties, Inc., 12 Mass. App. 201, 422 N.E.2d 798 (1981)(minority shareholder who refused to vote in favor of dividend payments ordered to pay accumulated earnings tax and all other penalties; and in addition shareholders were required to file with the court a dividend policy with respect to future dividends).

[211] 64 N.Y.2d 63, 473 N.E.2d 1173, 484 N.Y.S.2d 799 (1984).

[212] 64 N.Y.2d 63, 73, 473 N.E.2d at 1177-80, 484 N.Y.S.2d at 803-04 (1984).

[213] 64 N.Y.2d 63, 74, 473 N.E.2d at 1180, 484 N.Y.S.2d at 806 (1984).

presented, the defendants have the burden of demonstrating that some relief other than dissolution is an appropriate remedy, and the defendants had failed to present any alternatives.[214] One major distinction between *Gimpel v. Bolstein* and *Kemp & Beatley* is that in *Gimpel*, the corporation did not alter any existing policies when the plaintiff left. This difference was mentioned in the *Gimpel* opinion.[215]

Another case illustrating the significance that relative fault plays in the decisions is *Orchard v. Covelli*.[216] Beginning in 1962 Robert Orchard and Albert Covelli operated a group of McDonald's franchises in Erie, Pennsylvania. Orchard was the manager of the restaurants, and Covelli was the President. Ultimately the chain grew to seven restaurants, each of which was operated as a separate corporation. A group of investors from Chicago held forty-five percent of the shares in six of the corporations. Covelli held forty percent and Orchard the remaining fifteen percent. Covelli owned eighty-five percent of the stock in the seventh corporation and Orchard owned the remaining fifteen percent. Orchard claimed, however, that he should have received fifty percent of the stock in this restaurant under an oral agreement with Covelli that they would be equal partners in any restaurant in which the Chicago investment group did not invest. Orchard claimed he was unaware of the Chicago group's non-participation until several years after the seventh restaurant began operating.

In 1977, the Chicago investment group negotiated a sale of their stock with Covelli. The stock was purchased by the six corporations in which the group owned stock pursuant to a redemption agreement. When Orchard found out about this deal, he demanded that his shares also be purchased. Covelli agreed to do so but negotiations over the price reached an impasse after Covelli refuse to pay anything for Orchard's interest in the seventh restaurant. When Orchard refused to cave in, Covelli fired him as the manager of all the restaurants and at the next annual shareholders' meeting removed him as a director in all the corporations. The corporations also ceased paying dividends.

Sometime after this, Orchard apparently moved to Florida and obtained one or more franchises with a competitor of McDonald's. Then in 1981, three of the Erie franchises expired. In the course of renegotiating the renewal of these franchises with McDonald's, Covelli's lawyers disclosed Orchard's connection with a competitor. McDonald's had previously expressed some dissatisfaction with Orchard's performance as manager of the Erie restaurants. For these and other reasons, McDonald's ultimately decided to reissue the franchises to Covelli individually. Subsequently, Covelli transferred these franchises to new

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[214] *Id.* at 64 N.Y.2d at 73-74, 473 N.E.2d at 1180, 484 N.Y.S.2d at 806 (1984).

[215] Gimpel v. Bolstein, 125 Misc. 2d 45, 54, 477 N.Y.S.2d 1014, 1021 n.9 (1984).

[216] 590 F. Supp. 1548 (W.D. Pa. 1984).

corporations owned entirely by him and agreed to purchase at their book value the leasehold improvements, equipment, furniture and fixtures owned by the corporations in which he and Orchard held stock.

Orchard filed suit alleging multiple causes of action. The court found that Covelli was not guilty of any misappropriation of corporate assets, that Orchard did not have an enforceable employment contract with the various corporations and that there was insufficient evidence to support the oral agreement which would have given Orchard fifty percent interest in the seventh franchise. Relying on the strict fiduciary duty concept enunciated in *Donahue v. Rodd Electrotype Company of New England, Inc.*,[217] however, the court found that the unjustified freeze-out of Orchard engineered by Covelli, the failure to pay any dividends following the freeze-out, Covelli's refusal to compensate Orchard for the seventh restaurant, and Covelli's failure to use his best efforts to obtain the franchise renewals in the name of the corporations jointly owned by Orchard and Covelli, in combination, constituted a breach of fiduciary duty that justified some remedy.[218] The court rejected dissolution as being too "drastic."[219] Instead the judge ordered Covelli to purchase or cause the various corporations to purchase[220] for cash all of Orchard's stock in all seven corporations[221] at the same price per share as was offered to the Chicago investment group, together with prejudgment interest of six percent from February 28, 1977, the date of the agreement with the Chicago investment group.[222] The court stated that "[s]uch relief

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[217] 367 Mass. 578, 328 N.E.2d 505 (1975). See *supra*, notes 45-46 and accompanying text and *infra* notes 217, 281-82 and accompanying text for further discussion of the *Donahue* case.

[218] The court pointed out that although Orchard's acquisition of the Florida franchises was a technical violation of the McDonald's franchise agreements, it did not directly harm the existing corporations jointly owned by Orchard and Covelli nearly as much as Covelli's actions. The court also pointed out that Orchard's acquisition of other business interests was a "predictable response" to the squeeze-out. *See* 590 F. Supp. at 1558-59.

[219] *Id.* at 1559.

[220] The order required Covelli to pay out of his own funds any balance due to the Chicago investment group under the 1977 redemption agreement.

[221] With respect to the seventh corporation, the judge ruled that Orchard should be allocated 27.5 percent of the value of the stock even though he technically only owned fifteen percent of the stock. Orchard owned 27.5 percent of the stock in the other six corporations following the redemptin of the stock owned by the Chicago investment group. The judge had previously ruled that there was insufficient proof of the oral agreement that would have given Orchard fifty percent of the stock in this corporation. 590 F. Supp. at 1555-56. The judge stated he was awarding Orchard a 27.5 percent interest rather than the fifteen percent he owned as punishment for Covelli's failure to disclose the existence of the seventh restaurant to the Chicago investment group.

[222] By keying the buy-out to the Chicago investment group sale, the court avoided several potentially difficult valuation issues. That sale was an arm's-length negotiated transaction, and therefore the price per share should approximate any fair value determined by the court. In addition, the fair value of the seven jointly owned corporations in

is adequate to redress his [Orchard's] claim of breach of the fiduciary duty and is necessary to bring the business dealings of the parties to an end."[223]

The final two cases to be discussed in this section involved dissension between former spouses, both of whom owned stock in a close corporation.[224] In addition to illustrating the effect of improper conduct on the ultimate outcome, these cases also illustrate the need to have a buy-out agreement that will avoid the possibility of both spouses owning stock after a divorce.[225]

In re Trocino[226] involved a taxicab company incorporated by Joseph Trocino in 1982. Joseph subsequently voluntarily transferred fifty percent of the stock to his wife, Marguerita. As part of a property settlement agreement when they divorced in 1983, Joseph also transferred another one percent of the stock to Marguerita. In January 1984, Joseph offered to sell his remaining shares to Marguerita, who made an offer of $8,000. She refused, however, to allow him full access to the corporate records. Their negotiations were apparently not very harmonious, and Joseph filed suit seeking involuntary dissolution of the corporation, claiming among other wrongs that Marguerita had made improper loans of $37,000 to herself from the corporation. Marquerita filed a petition under Section 1118 of the New York Business Corporation Law[227] to buy out Joseph's shares. The Supreme Court felt that this was an appropriate resolution and ordered a fair value hearing. The judge also required Marguerita to make available to Joseph all relevant corporate records[228] and enjoined Joseph from entering the corporation's place of business or

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1977 was probably considerably greater than at the time the order was issued in this case because of the franchise terminations in three of the corporations.

[223] 590 F. Supp. at 1560.

[224] *See also* Bricklin v. Stengol Crop., 1 Conn. 656, 476 A.2d 584 (1984)(shares in a close corporation and limited partnership owned by former spouse ordered to be purchased; stock issued to her former husband and another shareholder ordered cancelled; improper expenditures ordered repaid, and judgment rendered for $14,000 to compensate for a lease of corporate property to a shareholder at an unreasonably low rental).

[225] See ORGANIZING A SMALL BUSINESS ENTITY, *supra* note 2, § 5.04(c)(3)(e)(1984) for suggestions on the alternative buy-out schemes that might be used for this purpose.

[226] 126 Misc.2d 394, 482 N.Y.S.2d 670 (1984).

[227] N.Y. BUS. CORP. LAW § 1118 (McKinney 1986). See *supra* notes 112-17 and accompanying text for further discussions of this and similar statutory provisions.

[228] Access to corporate records was also ordered in two other New York involuntary dissolution opinions issued in 1984 and 1985. *See* Gimpel v. Bolstein, 125 Misc. 2d 45, 56, 477 N.Y.S.2d 1014, 1022 (1984); *In re* Levitt, 109 A.D.2d 502, 492 N.Y.S.2d 736, 741-42 (1985)(access to corporate records limited to a period prior to commencement of involuntary dissolution suit: (1) because the defendants had exercised a statutory right to purchase the plaintiff's shares and the statute fixes the valuation date as of the day preceding the date of the suit was filed, and (2) the plaintiff was working for a competitor). Other courts have also directed that minority shareholders be granted access to corporate records. *See, e.g.*, Riser v. Genuine Parts Co., 150 Ga. App. 502, 258 S.E.2d 185 (1979).

in any fashion interfering with the corporation's day-to-day business activities.[229]

In *Stefano v. Coppock*,[230] Patricia Coppock Muir, the former wife of one of three equal shareholders in an Alaska corporation, received one-half of her husband's stock at the time of their divorce in 1970. During the next four years, she received virtually no information about the corporation and was not properly informed of shareholders' meetings. She retained an attorney and attempted to negotiate a sale of her shares. The other shareholders offered to purchase her shares at $133 per share or to sell her their shares for $266 per share. Mrs. Muir then filed suit in 1976 and the trial court ordered her shares to be purchased for $213 per share plus interest from 1974 and attorneys' fees. Following a remand of the case for more specific findings of fact in an opinion issued in 1980,[231] the Alaska Supreme Court in 1985 affirmed the trial court's monetary judgment based on a finding that the founding shareholders' actions constituted oppressive conduct.[232] The case was remanded a second time, however, to make more specific findings on the amount of the attorneys' fees.[233]

One interesting aspect of this case was the court's reaction to the contention by the three founding shareholders that a court-ordered buy-out was more drastic than dissolution and that in any case dissolution was the only remedy specifically authorized in the applicable Alaska Business Corporation Act statute. The court stated that other equitable remedies are not precluded and:

> [m]oreover, we are not persuaded that ordering a buy-out of an oppressed minority shareholder's interest is more drastic than ordering the death of the corporation. From the controlling shareholders' point of view, the buy-out may be more costly, but such a remedy provides an effective means of fairly compensating the aggrieved shareholder here. The buy-out remedy fits the situation in this case.[234]

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[229] The inspection of the corporate books and records was ordered to take place in the courthouse or some other site selected by the litigants' lawyers. *In re* Trocino, 126 Misc. 2d 394, 397, 482 N.Y.S.2d 670, 673. For another case where the court limited a belligerent plaintiff's access to the corporation's business premises, see *In re* Levitt, 109 A.D.2d 502, 505-510, 492 N.Y.S.2d 736, 741-42 (1985).

[230] 705 P.2d 443 (Alaska 1985).

[231] *See* Alaska Plastics, Inc. v. Coppock, 621 P.2d 270 (Alaska 1980).

[232] 705 P.2d at 445-46.

[233] The amount of the attorneys's fee award was $20,000, which is quite substantial in light of the final buy-out price of $32,000. The Alaska Supreme Court ruled, however, that the trial court did not follow established guidelines in determining the amount of the fee.

[234] 705 P.2d at 446.

D. *The No-Relief Cases*

The four involuntary dissolution cases in 1984 and 1985 in which no significant substantive relief was granted illustrate two important points: (1) courts are unwilling to grant relief in the absence of a protracted voting deadlock where there are mere policy disagreements between the shareholders and no evidence of a freeze-out or other unjustified or improper conduct by the majority shareholders; and (2) inadequacies in a state's involuntary dissolution statute can result in dismissal at the pleading stage of a case that would be tried on the merits in many other states.

In *In re Dubonnet Scarfs, Inc.*,[235] Arthur Olshan owned fifty percent of the stock in Arkwright Accessories, Inc., a New York corporation, and the other fifty percent was owned by Dubonnet Scarfs, Inc., a New Jersey corporation. Dubonnet in turn was owned by Fred Thomas and Florence Thomas, who held part of her stock as a nominee for Fred and the remainder as a nominee for Harry Gordon, a business partner of Fred's. In 1982 Harry and Fred filed for bankruptcy reorganization after a demand was made that they honor personal guarantees on several loans made to some of their other joint ventures. Dubonnet on their behalf asked that Arkwright redeem the Dubonnet stock. Olshan, who had been the principal manager of Arkwright since its formation in 1952, refused this request. Dubonnet then filed suit requesting involuntary dissolution of Arkwright claiming that Arkwright had sufficient liquid assets to finance the purchase and that the failure to do so resulted in a deadlock and also constituted oppression. Dubonnet also alleged that Olshan had misrepresented the value of Arkwright's assets during the negotiations over the requested buy-out.

The trial court dismissed the complaint. The Appellate Division of the New York Supreme Court in a 4-1 decision affirmed. The appellate court pointed out that:

> [t]he petitioners present no legal authority that holds that a shareholder in a close corporation, who is in personal financial difficulty, which is unrelated to that corporation, can demand to be bought out, because he or she needs the cash to satisfy personal creditors, and that if such demand is not complied with, then such shareholder can seek the dissolution of that corporation.[236]

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[235] 105 A.D.2d 339, 484 N.Y.S.2d 541 (1985). Other cases a court refused relief when the evidence showed mere policy differences between the shareholders unaccompanied by any oppressive action include *In re* A Company, [1983] 2 All E.R. 36 (Ch. Div.); Barnett v. International Tennis Corp., 80 Mich. App. 396, 263 N.W.2d 908 (1978); and Hockenberger v. Curry, 191 Neb. 404, 215 N.W.2d 627 (1974).

[236] 105 A.D.2d at 343, 484 N.Y.S.2d at 544.

This opinion is particularly significant because it specifically rejects the concept of a no-fault judicial buy-out as a method of resolving the problems created by the inherent illiquidity of close corporation stock. This concept, advocated by respected close corporation commentators,[237] will be discussed further in Part V.[238]

Coduti v. Hellwig,[239] a 1984 decision issued by the Illinois Appellate Court, is a good example of the difficulties a minority shareholder has in convincing a court to grant relief where the majority does not attempt a freeze-out or take other unjustifiable action. James Coduti and Werner Hellwig formed Hudson Tool & Die Corporation in 1954. Coduti, who ran the corporation's production facilities, owned approximately forty percent of the stock; and Hellwig, the President, owned approximately sixty percent of the stock. Coduti and Hellwig operated Hudson without any serious disagreements until 1977. Thereafter, they had a number of disputes that culminated in this suit, which took twenty-four days to try. The disputes were determined by the trial court to be relatively minor policy disputes and personality clashes. For example, Coduti complained about Hudson's bonuses and dividend policy. The evidence showed, however, that generous bonuses had been paid to him on a regular basis, that the one dividend declared by Hudson had been delayed for several months at Coduti's request, and that Coduti had never presented a resolution requesting that dividends be paid.[240] Coduti also complained that Hellwig improperly obtained approval of a resolution authorizing Hellwig to sign checks without Coduti's co-signature contrary to a long-standing policy requiring both their signatures on all checks. Hudson testified, however, that the resolution question was passed because Coduti had refused for two weeks to sign checks that would transfer funds from the general account to the accounts payable and payroll accounts. After learning of the Board's resolution, Coduti resumed signing checks and no further check signing problems had occurred.[241]

The most serious dispute occurred in 1980 when Hellwig wrote a memorandum rescinding Coduti's authority to make bids to customers. Hellwig justified this action on the grounds that business had fallen off more than fifty percent, and he felt that he needed to take a more active

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[237] *See* Hetherington & Dooley, *supra* note 145, pp. 32-62. The Hetherington & Dooley proposal has been criticized by other commentators as being too impractical. *See* Easterbrook & Fischel, *Close Corporations and Agency Costs*, 38 STAN. L. REV. 271, 287-290 (1986); Hillman, *The Dissatisfied Participant in the Solvent Business Venture: A Consideration of the Relative Permanence of Partnerships and Close Corporations*, 67 MINN. L. REV. 1, 75-87 (1982).

[238] *See infra* note 289.

[239] 127 Ill. App. 3d 279, 469 N.E.2d 220 (1984).

[240] *Id.* at 285, 469 N.E.2d at 226.

[241] *Id.* at 286, 469 N.E.2d at 226-27.

role in running the corporation. When he saw the memorandum, Coduti lost control and, shouting obscenities and brandishing a piece of copper, chased Hellwig into the plant. Hellwig had Coduti arrested for aggravated assault and sent him a letter of dismissal. The board of directors, however, took no action to remove Coduti as an officer; and Coduti continued working and received the same salary and vacation pay as before this incident.[242]

The trial court found that Hellwig's acts did not constitute oppression, fraud, illegality, waste, or breach of fiduciary duty. The appellate court, in affirming, pointed out that it had the power to reverse the trial court's findings only if they were against the manifest weight of the evidence, which means that "upon hearing such evidence, no reasonable person would reach the conclusion arrived at by the trial court."[243] The appellate court also held that Coduti's complaints clearly did not justify involuntary dissolution of Hudson and that because there was no oppression, deadlock, or other ground for involuntary dissolution, the court had no power to order a buy-out or other remedy even though the Illinois Business Corporation Act had been amended during the pendency of the appeal specifically to authorize relief other than dissolution.[244]

The final two no-relief cases both involved alleged freeze-outs. In the first, *Allen v. Royale "16", Inc.*,[245] a minority shareholder in a Louisiana close corporation sued for involuntary dissolution after he was dismissed as President and removed from the board of directors. Although the plaintiff claimed the corporation was to be operated by unanimous consent, the court held the proof on this issue inadequate.[246] Therefore, there was no deadlock. The only other possible grounds for involuntary dissolution under the applicable Louisiana statute were insolvency, failure or abandonment of corporate purposes, *ultra vires* acts, and benefit to the interests of the shareholders. The court held that the alleged deficiencies in the corporation's accounting procedures, failure to hold board meetings since this lawsuit was filed and the corporation's precar-

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[242] Contrast the restraint shown in Coduti v. Hellwig with *In re* T.J. Ronan Paint Company, 98 A.D.2d 413, 469 N.Y.S.2d 931 (1984) discussed *supra* notes 161-63 and accompanying text, and Notzke v. Art Gallery, Inc., 84 Ill. App. 3d 294, 39 Ill. Dec. 860, 405 N.E.2d 839 (1980)(dissolution ordered).

[243] 127 Ill. App. 3d 279, 286, 469 N.E.2d 220, 227.

[244] *Cf.* Johnston v. Livingston Nursing Home, 221 So.2d 151 (Ala. 1968)(no relief granted even though two sisters, who were the controlling shareholders, had major policy disagreement and sometimes physically assaulted one another; no evidence of fraud, oppression or freeze-out); Collier v. Collier, 61 Ill. App. 3d 1011, 378 N.E.2d 405 (1978)(deadlock for four months insufficient time period to justify relief); Baker v. Commercial Body Builders, Inc., 264 Or. 614, 507 P.2d 387 (1973)(refusal to allow access to corporate records or to give notice of shareholders' meeting for a one-year period held non-actionable; corrective action taken prior to trial).

[245] 449 So. 2d 1365 (La. App. 1984).

[246] *Id.* at 1367-68.

ious but improving financial situation did not fall within any of these statutory provisions.[247] The court further held that the removal of Allen as President and a member of the board of directors "were within the corporate powers and not *ultra vires*."[248] All claims were therefore dismissed and the dismissal was upheld on appeal.

Significantly, the Louisiana involuntary dissolution statute[249] does not contain an oppression provision. Oppression is also omitted from the Georgia involuntary dissolution statute,[250] and this omission may have played a role in the outcome in *Gregory v. J.T. Gregory & Son, Inc.*,[251] a 1985 decision by the Georgia Court of Appeals. After acting merely as the titular President of a family corporation for sixteen years while he was employed by another company, J.T. Gregory, Sr. reasserted his authority through ownership of fifty-one percent of the stock in 1981 and two years later fired his son, who ran the corporation during his father's absence, and removed him from the board of directors. The father then caused the corporation to file suit against the son demanding the return of a car and boat allegedly belonging to the corporation and money the son had allegedly borrowed from the corporation or used to pay personal expenses. The son counterclaimed for involuntary dissolution. The Georgia Court of Appeals affirmed the trial court's dismissal of the involuntary dissolution claim on a summary judgment motion.[252] The court held that the only possible statutory grounds supporting involuntary dissolution were deadlock and waste. There was no deadlock, however, since the father held fifty-one percent of the stock;[253] and although the son made allegations of mismanagement, he failed properly to plead a cause of action for misapplication or waste of the corporation's assets.

The decision in both these cases may well have been the same even if the Louisiana and Georgia statutes authorized involuntary dissolution because of oppression. Nevertheless, the large number of cases where

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[247] *Id.* at 1368-70.

[248] *Id.* at 1370.

[249] *See* LA. REV. STAT. ANN. § 12:143 (West 1969 & Supp. 1986).

[250] *See* GA. CODE ANN. § 14-2-285 (1982).

[251] 338 S.E.2d 7 (Ga. Ct. App. 1985).

[252] The corporation was granted summary judgment for the automobile and the money it claimed the son owed; but the court held that a dispute over the ownership of the boat must be resolved by a trial on the merits.

[253] The son claimed that the by-laws, which along with other corporate documents had been destroyed in a 1964 fire, contained a two-thirds quorum requirement. If this was the case, the resolutions giving the father the authority to fire him would have been illegal since the son, who owned forty-nine percent of the stock was not present at the meeting when the resolution was passed. The only evidence of this fact was a set of by-laws typed after the fire by the secretary of the lawyer who had handled the incorporation. She could not remember whether she had copied these by-laws from the lawyer's file on the corporation or from some other source. The court held that there was insufficient evidence to support the two-thirds quorum requirement.

relief on oppression grounds has been granted to minority shareholders who have been dismissed as employees and removed from the boards of directors calls into question the wisdom of omitting this important concept from involuntary dissolution statutes.[254]

IV. Other Remedies

There are a variety of other types of lawsuits that can potentially be brought to remedy close corporation intra-corporate dissension. The most common are causes of action based on violation of federal and state securities acts, breach of fiduciary duty, and common law conspiracy and fraud.[255] Frequently, however, the prerequisites for these alternative causes of action may not exist in the particular fact situation, or, even if they do, the remedies that can be granted by the court will be unsatisfactory.

For example, unless the challenged action involves a purchase or sale of stock, it is very unlikely that a shareholder cause of action based on securities laws violation will be successful.[256] Many common forms of squeeze-outs, for instance, removal of a shareholder from all managerial responsibilities, do not, however, involve purchases or sales of securities. To the contrary, the fact that the squeezed-out shareholder cannot sell his or her stock because there is no market for it is one of the principal reasons why a judicial remedy is pursued.

In addition, if the court construes the action as being essentially grounded on a wrong to the corporation rather than an injustice to the shareholder *qua* shareholder, then the court is likely to require that the action qualify as a derivative action.[257] This determination not only

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[254] *See, e.g., In re* T.J. Ronan Paint Company, 98 A.D.2d 413, 469 N.Y.S.2d 931 (1984), discused *supra* notes 161-63 and accompanying text; Mordka v. Mordka Enterprises, Inc., 143 Ariz. 298, 693 P.2d 953 (Ct. App. 1984), discused *supra* notes 164-68 and accompanying text; *In re* Wiedy's Furniture Clearance Center, Co., Inc., 108 A.D.2d 81, 487 N.Y.S.2d 901 (1985), discussed *supra* notes 193-200 and accompanying text. *See also supra* notes 40-64 and accompanying text.

[255] *See generally* O'Neal's Oppression of Minority Shareholders, *supra* note 1, §§ 7:01-8:22.

[256] *See, e.g.*, Ketchum v. Green, 557 F.2d 1022 (3d Cir. 1977). *See generally* O'Neal's Oppression of Minority Shareholders, *supra* note 1, §§ 7:12-7:13, 8:01-8:22.

[257] Because of differing and sometimes conflicting rationales used by the courts to differentiate between direct and derivative actions, it is often difficult to predict how a court will rule in a particular case. *See* Welch, *Shareholder Individual and Derivative Actions: Underlying Rationales and the Closely Held Corporation*, 9 J. Corp. L. 147, 153-69 (1984)(hereafter "Welch"); Laws of Corporations, *supra* note 44, § 360. The essential difference appears to be whether the alleged wrongful act depletes corporate assets and thereby only indirectly harms the shareholders, or the alleged wrongful act essentially harms a personal or individual right of a shareholder. *See* American Law Institute,

increases the procedural hurdles the plaintiff will have to meet in order to recover,[258] but will also, with rare exceptions, result in judgment requiring payment of any damage awarded to the corporation.[259] While the plaintiff will indirectly benefit from the judgment, so will the shareholders who were the wrongdoers. Moreover, even if a direct action is allowed, a court will, as a general rule, only award restitutionary damages, or in the case of a wrongful appropriation of corporate property, create a constructive trust.[260] Dissolution and many of the other equitable remedies used by courts in involuntary dissolution suits are generally held not to be applicable.[261]

Some of the difficulties encountered in bringing such actions are illustrated by three recent cases. In *Abrams v. Donati*,[262] the former President of Donati, Inc. sued the remaining shareholders and two other corporations claiming a conspiracy to terminate his employment and to depress the value of Donati, Inc.'s stock so that it could be purchased from the plaintiff at a greatly reduced price, as well as mismanagement, and

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PRINCIPLES OF CORPORATE GOVERNANCE: AN ANALYSIS AND RECOMMENDATIONS DISCUSSION § 7.01 Comment (Draft No. 1 1985)(hereinafter ALI PRINCIPLES OF CORPORATE GOVERNANCE).

258 State derivative action statutes and cases as a general rule require the plaintiff to own stock in the defendant corporation both at the time the transaction complained of took place and at the time the suit is filed, require the plaintiff to prove that intra-corporate remedies have been exhausted (the demand requirement), impose strict pleading requirements not applicable to direct actions, and, unlike direct actions, require court approval of any pre-judgment settlement. Many states also require a plaintiff in a derivative action to post a security bond. *See* Welch, *supra* note 44, §§ 361-67, 372; ALI PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 257, §§ 7.02-7.15.

On the other hand, from a plaintiff's viewpoint, derivative actions are more advantageous than direct actions for the following reasons: (1) attorneys' fees can generally be recovered in a derivative action but not in a direct action; and (2) the defendants in a derivative action cannot normally file counterclaims against the party filing the action. *See* Welch, *supra* note 257 at 152, 190-92; LAWS OF CORPORATIONS, *supra* note 44, §§ 368, 377.

259 *See* Welch, *supra* note 257 at 180-89; LAWS OF CORPORATIONS, *supra* note 44, § 373. Some courts have authorized a direct or *pro rata* recovery by a shareholder in a derivative action in situations where creditors of the corporation are not adversely affected and all the shareholders who are affected by the action are before the court. *See, e.g.*, Watson v. Button, 235 F.2d 235 (9th Cir. 1956); Lynch v. Patterson, 701 P.2d 1126 (Wyo. 1985); Thomas v. Dickson, 250 Ga. 772, 301 S.E.2d 49 (1983), *aff'g* 162 Ga. Ap. 569, 91 S.E.2d 747 (1982). This result is approved in the ALI PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 257, §§ 7.01(d), 7.16(e).

260 Some cases have authorized punitive damages in direct actions, however. *Compare, e.g.*, Holden v. Construction Mach. Co., 202 N.W.2d 348 (Iowa 1972) *with* Beals v. Washington International, Inc., 386 A.2d 1156 (Del. Ch. 1978).

261 As with all general rules, there are exceptions. *See, e.g.*, Evans v. Blesi, 345 N.W.2d 775 (Minn. Ct. App. 1984)(breach of fiduciary duty case in which actual and punitive damages were awarded; and in addition the court ordered a two-year buy-out procedure established during which time the shareholders were enjoined from seeking dissolution of the corporation or entering into a competing business).

262 66 N.Y.2d 951, 498 N.Y.S.2d 782, 489 N.E.2d 751 (Ct. App. 1985), *aff'g*, 485 N.Y.S.2d 1012 (1985).

diversion of corporate assets. For some unexplained reason, a separate cause of action seeking damages for wrongful discharge was discontinued. The New York Supreme Court dismissed the main cause of action based on the conspiracy theory, stating that it was based on a wrong to the corporation theory and therefore must be brought as a derivative suit.[263] The New York Court of Appeals, in a brief memorandum opinion issued in December, 1985 affirmed, pointing out that the plaintiff had mixed individual and derivative causes of action and had not plead any specific acts showing a breach of a duty owed to him independent of the duty owed to the corporation.[264] The Court of Appeals also upheld the trial court's decision denying the plaintiff the right to file amended pleadings.[265]

In the second case, *Landorff v. Glottstein*,[266] the plaintiff, who owned twenty-five percent of the shares in a close corporation, filed a multiple cause of action complaint against the corporation, its directors and the other shareholders based on his dismissal as an executive employee of the corporation in charge of financial matters and the reduction in his salary from $90,000 to $20,000 per annum. The New York Supreme Court found that in the absence of an employment agreement, the plaintiff was an at-will employee subject to termination at anytime without cause; and further found that although there was a shareholder agreement which required the shareholders to elect the plaintiff secretary and treasurer, there was no agreement or statute which required any specified duties for these offices, which the plaintiff technically continued to hold.[267] Based on these findings, the court refused to enjoin the implementation of the challenged action and dismissed four different causes of action seeking injunctive relief and damages for the dismissal and salary reduction. A fifth cause of action against one of the other shareholders for tortious interference with the alleged employment agreement and a sixth cause of action alleging damage to the plaintiff's reputation in the textile industry caused by the dismissal were also dismissed. Nevertheless, the court, citing other New York cases involving close corporations,[268] gave the plaintiff twenty days to file an amended complaint specifically alleging a breach of the fiduciary duty owed to him by the remaining shareholder.

Webber v. Webber Oil Company,[269] the third case, involved an attempted ouster of Larry Maheney, the President of a group of family

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[263] 108 A.D.2d 704, 485 N.Y.S.2d at 1012-13.

[264] 66 N.Y.2d at 951, 498 N.Y.S.2d at 782-83, 489 N.E.2d at 752.

[265] 66 N.Y.2d at 951, 498 N.Y.S.2d at 783, 489 N.E.2d at 752.

[266] 500 N.Y.S.2d 494 (Sup. Ct. 1986).

[267] *Id.* at 496-97.

[268] Alpert v. 28 Williams St. Corp., 63 N.Y.2d 557, 473 N.E.2d 19, 483 N.Y.S.2d 667 (1984); Fender v. Prescott, 101 A.D.2d 418, 476 N.Y.S.2d 128 (1984), *aff'd*, 64 N.Y.2d 1077, 479 N.E.2d 225, 489 N.Y.S.2d 880 (1985).

[269] 495 A.2d 1215 (Me. 1985).

corporations, by one Danville Webber. The attempted ouster was followed by a substantial reduction in Webber's salary ($57,000 to $12,000) and a disproportionate reduction in dividends paid to Webber, engineered by the shareholders supporting Maheney. The attempted coup took place when one of the directors was abroad and unable to attend the board of directors meeting at which the removal vote was taken, with the result that the board was evenly split on the removal motion. Webber, as the leader of the faction seeking dismissal, asserted that Maheney had a conflict of interest and was therefore ineligible to vote, thereby making the vote two to one in favor of removal.

The absent director subsequently returned and at a later board meeting voted to rescind the prior action and to reinstate Maheney as President. This motion carried three to two. The plaintiffs then filed an action, which for the most part was derivative in nature, seeking judicial removal of Maheney and charging gross mismanagement and breach of fiduciary duty. The Supreme Judicial Court of Maine upheld the trial court's action in dismissing the causes of action relating to the removal of Maheney on the grounds that under Maine law Maheney was entitled to vote on his own dismissal as an officer, and the court had no inherent equitable power to remove a director or officer in the absence of proof of fraud.[270] Moreover, the court upheld the dismissal of all the remaining derivative causes of action based on mismanagement, diversion of corporate opportunities, and waste, primarily because the plaintiffs had failed to meet the statutory pleadings requirements for derivative actions and had also failed to make a proper demand on the corporation prior to filing the action.[271] The court did, however, reverse the trial court's dismissal of Count VI of the Complaint which alleged a breach of fiduciary duty involving the reduction of Danville Webber's salary and dividends; but it did not reinstate an injunction issued by the lower court keeping Webber's salary at its prior level pending a trial on the merits.[272]

Many of the procedural difficulties encountered in these three cases would not have existed had the complaints been brought as involuntary dissolution suits in which the corporation and all the shareholders were parties. In fact, in *Landorff v. Glottstein*,[273] the court observed that the

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[270] *Id.* at 1221. *Cf.* Cressy v. Shannon Continental Corp., 378 N.E.2d 941, 946 (Ind. Ct. App. 1978)(court has no inherent power in a breach of fiduciary duty case to order amendment of articles of incorporation changing voting stock to nonvoting stock). *But see* Zion v. Kurtz, 50 N.Y.2d 92, 428 N.Y.S.2d 199, 405 N.E.2d 681 (1980)(a court has the power to amend the articles of incorporation to validate a shareholder agreement).

[271] 495 A.2d at 1221-23.

[272] 495 A.2d at 1224-25. In addition, the Supreme Judicial Court of Maine reversed the dismissal of a cause of action by Webber against the trustees of a voting agreement trust that held a majority of the shares. *Id.* at 1223-24. This cause of action was also based on a breach of fiduciary duty theory.

[273] 500 N.Y.S.2d 494, 496-97 (Sup. Ct. 1986).

facts presented precisely the type of situation the New York close corporation involuntary dissolution statutes were designed to remedy.[274] Moreover, the possibility of court-ordered dissolution provides additional leverage for a plaintiff to bargain for a buy-out or other satisfactory settlement of the action that does not exist in these other types of suits.

This does not mean that all suits involving oppression and related claims should be cast solely as involuntary dissolution suits. As was pointed out in Part II,[275] involuntary dissolution suits have significant shortcomings, especially in states having statutes that create severe procedural limitations to such suits or caselaw that indicates a reluctance to grant relief other than dissolution. It is also easier to recover attorneys' fees in certain other types of actions, particularly in derivative actions,[276] and treble damages may be recoverable for some statutory causes of action such as the Racketeer Influenced and Corrupt Organization Act (RICO)[277] and federal and state unfair trade practice and anti-trust statutes.[278] Therefore, in order to maximize the possibilities of recovery, frequently the most advisable course of action is to join one or more additional causes of action to an involuntary dissolution complaint.[279]

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[274] N.Y. BUS. CORP. LAW §§ 1104-a, 1118 (McKinney 1986). These provisions are discussed *supra*, notes 62-64, 112-17, 194-96 and accompanying text. Interestingly, the Maine involuntary dissolution statute does not contain an oppression provision. *See* ME. REV. STAT. ANN. tit. 13A, § 1111 (1981). Perhaps this is the reason Webber v. Webber Oil Company, discussed *supra* notes 269-72 and accompanying text was based exclusively on other causes of actions. *See also supra* notes 245-54 and accompanying text.

[275] *See supra* notes 33-117 and accompanying text.

[276] *See* LAWS OF CORPORATIONS, *supra* note 44, § 377; ALI PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 257, §7.17. As a general rule, in the absence of statutory authority, courts are very reluctant to award attorneys' fees in any corporate shareholder dispute other than a derivative action. *See, e.g.*, Baker v. Pratt, 176 Cal. App. 370, 222 Cal. Rptr. 253, 257-59 (1986). *See also supra* notes 97-100 and accompanying text. An increasing number of statutes specifically authorize recovery of attorneys' fees. *See, e.g.*, S.C. CODE ANN. § 39-5-140 (Law. Co-op. Supp. 1985)(state unfair trade practices act).

[277] 18 U.S.C. §§ 1961-68. (Law. Co-op. 1979).

[278] *See, e.g.*, S.C. CODE ANN. § 39-5-140 (Law. Co-op. Supp. 1985).

[279] Although older cases ruled that direct actions such as a breach of fiduciary duty claim and an involuntary dissolution claim could not be joined with a derivative cause of action, the trend is toward allowing joinder, at least during the initial stages of the litigation. *See* Welch, *supra* note 257, at 193-94; LAWS OF CORPORATIONS, *supra* note 44, § 368. Joinder of other causes of action with involuntary dissolution suits is quite common. *See, e.g.*, Hackbart v. Holmes, 675 F.2d 1114 (10th Cir. 1982); Meiselman v. Meiselman, 309 N.C. 279, 307 S.E.2d 551 (1983). *But see infra* note 281. A final order on one of the causes of action may, however, have an impact on the others. *See* Miller v. Ruth's of North Carolina, Inc., 69 N.C. App. 672, 318 S.E.2d 2 (1984)(court ordered a buy-out in involuntary dissolution suit but mooted derivative cause of action because facts giving rise to derivative action took place after the date established by the court for purchase of the plaintiff's shares).

Finally, in states like Ohio[280] and Massachusetts[281] where involuntary dissolution by minority shareholders is virtually impossible because of overly restrictive statutes, plaintiffs will have to rely exclusively on the other types of actions.[282]

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[280] The Ohio Business Corporate Code only authorizes involuntary dissolution upon the petition of one-half the directors or the holders of one-half of the voting stock in a deadlock situation unless the articles of incorporation otherwise provide. OHIO REV. CODE ANN. § 1701.91(A)(4)(Page 1985). Two cases have held that this statute is preemptive and courts have no inherent equitable power to dissolve an Ohio corporation. Schrage v. Portsmouth Steel Corp., 207 F.2d 497 (6th Cir. 1953); Shearer v. Union Mortgage Co., 78 Ohio App. 373, 162 N.E. 696 (1928).

[281] Under MASS. GEN. LAWS ANN. ch. 156B § 99 (Michie/Law. Co-op. 1970), an involuntary dissolution suit must be filed as an original action in the Supreme Judicial Court of Massachusetts. Therefore, it is impossible to join an involuntary dissolution action with any other type of claim since all other claims must be filed in the superior court or some other trial court. *See* Cain v. Cain, 3 Mass. App. 467, 334 N.E.2d 650 (1975). *See also* Alkire v. Interstate Theatres Corp., 379 F. Supp. 1210 (D. Mass. 1974)(state statute is exclusive). The Massachusetts involuntary dissolution statute is also restrictive in other respects. For example, except when the corporation is deadlocked, only holders of at least fifty percent of the stock can petition for involuntary dissolution, unless the articles of incorporation otherwise provide. *See* Donahue v. Rodd Electrotype Co. of New England, Inc., 367 Mass. 578, 328 N.E.2d 505, 514-15 (1975); Drury v. Abdallah, 9 Mass. App. 865, 401 N.E.2d 154 (1980).

[282] Interestingly, courts in the states with the most restrictive involuntary dissolution statutes appear to be the most receptive to granting remedies for close corporation intracorporate dissension on a breach of fiduciary duty theory. This is particularly evident in Massachusetts. *See* Donahue v. Rodd Electrotye Co. of New England, Inc., 367 Mass. 578, 328 N.E.2d 505 (1975); Wilkes v. Springside Nursing Home, Inc., 370 Mass. 842, 353 N.E.2d 657 (1976); Cain v. Cain, 3 Mass. App. 467, 334 N.E.2d 650 (1975); Hallahan v. Haltom Corp., 7 Mass. App. 68, 385 N.E.2d 1033 (1979); Smith v. Atlantic Properties, Inc., 12 Mass. App. 201, 422 N.E.2d 798 (1981). Two recent Ohio cases endorse the strict fiduciary duty concept enunciated in the Massachusetts case. *See* Soulas v. Troy Donut University, Inc., 9 Ohio App. 3d 339, 460 N.E.2d 310 (1983); Estate of Schroer v. Stamco Supply, Inc., 19 Ohio App. 3d 34, 482 N.E.2d 975 (1984).

At the present time, however, the scope of the fiduciary duty cause of action and the remedies that can be awarded by a court in such an action are unclear. In the leading case of *Donahue v. Rodd Electrotype Co. of New England, Inc., supra*, the Supreme Judicial Court of Massachusetts made two major holdings: (1) shareholders in a closely-held corporation have a strict ficuciary duty to one another similar to the fiduciary duty among general partners in a partnership; and (2) minority shareholders are entitled to the same rights as the majority shareholders to the corporation's assets and therefore if a close corporation purchases shares from a member of the controlling group, it must also purchase an equal pro rata number of shares from the minority shareholders at the same price. *See generally* Bulloch, *Heightened Fiduciary Duties in Closely Held Corporations: Donahue Revisited*, 16 PAC. L.J. 935 (1985); Johnson, *Strict Fiduciary Duty in Close Corporations: A Concept in Search of Adoption*, 18 CAL. W. L. REV. 1 (1982); Note, *The Strict Good faith Standard Fiduciary Duties to Minority Shareholders in Close Corporations*, 33 MERCER L. REV. 595 (1982).

In subsequent cases, however, the Massachusetts courts appear to have modified the strict fiduciary duty concept. In *Wilkes v. Springside Nursing Home, Inc.*, 370 Mass. 842, for example, the Supreme Judicial Court of Massachusetts held that the strict fiduciary duty

V. Conclusion

Involuntary dissolution suits have proven to be an effective method of resolving protracted close corporation dissension that cannot be resolved amicably. For the most part, courts have done a highly credible job of fashioning remedies that are tailored to the specific factual situation presented.

Judges have consistently viewed dissolution as a last resort remedy that should only be ordered when there is an irreconcilable deadlock or

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standard is satisfied if the majority shareholders prove a legitimate business purpose for the challenged action and the minority shareholders fail to prove that an alternative course of action could have achieved the same business objective with less harm to the minority. *See also* Leader v. Hycor, Inc., 395 Mass. 215, 479 N.E.2d 173 (1985). As modified, the *Donahue* strict fiduciary duty concept is not substantively very different from the more traditional fiduciary duties of good faith and fair dealing that apply to corporate directors, officers and controlling shareholders. *See generally* Laws of Corporations, *supra* note 44 §§ 173, 235-41, 268; O'Neal's Oppression of Minority Shareholders, *supra* note 1, § 7:17. One major difference may be that the *Donahue* fiduciary duty concept focuses more on the potential harm to a minority shareholder regardless of the inherent fairness of the challenged transaction to the corporation, whereas, under the more traditional corporate rules relating to conflict of interest, a transaction will be upheld if those persons having a conflict of interest prove the fairness of the transaction to the corporation. *See* Johnson, *supra* p. 21-25. In the recent case of Horizon House-Microwave, Inc. v. Bazzy, 21 Mass. App. 190, 486 N.E.2d 70 (1985), however, the Appeals Court of Massachusetts seemingly ignored this distinction in upholding a freeze-out triangular merger that had the effect of substantially diluting the equity of a minority shareholder in the parent corporation.

The *Donahue* equal opportunity doctrine has also proven to be more limited than many commentators originally thought. Some cases have rejected the *per se* equal opportunity doctrine altogether with respect to corporate redemptions. *See* Toner v. Baltimore Envelope Co., 304 Md. App. 256, 498 A.2d 642 (1985). Even those courts that have endorsed the *Donahue* rationale have limited it to cases where there is no shareholder buy-out agreement and the corporation has purchased stock from a majority shareholder and subsequently has refused to purchase stock from a minority shareholder. *See* Comolli v. Comolli, 241 Ga. 471, 246 S.E.2d 278 (1978); Tillis v. United Parts, Inc., 395 So. 2d 618 (Fla. App. 1981); Estate of Schroer v. Stamco Supply, Inc., 19 Ohio App. 3d 34, 482 N.E.2d 975 (1984). It does not apply if the corporation has never purchased any shares from the majority shareholders. *See* Corlett, Killian, Hardeman, McIntosh and Levi, P.A. v. Merritt, 478 So. 2d 828 (Fla. App. 1985); Goode v. Ryan, 397 Mass, 85, 489 N.E.2d 1001 (1986). *Compare, e.g.*, Stefano v. Coppock, 705 P.2d 443 (Alaska 1985)(buy-out of shares ordered in an involuntary dissolution suit). Nor does it apply to any corporate repurchases made pursuant to a shareholder buy-out agreement or pursuant to the articles of incorporation or bylaws. *See* Donahue v. Electrolyte Co. of New England, Inc., 367 Mass. at 598, 328 N.E.2d at 518 n.24. Moreover, it does not apply to intra-shareholder sales. *See* Zidell v. Zidell, Inc., 277 Or. 413, 560 P.2d 1086 (1977); Johns v. Caldwell, 601 S.W.2d 37 (Tenn. App. 1980). Furthermore, most courts have refused to apply the equal opportunity rule to allow minority shareholders equal rights to sell shares to third parties or to share in any control premium received by the majority shareholders for the sale of their share. *See, e.g.*, Clagett v. Hutchison, 583 F.2d 1259, 1263-64 (4th Cir. 1978); Glass v. Glass, 228 Va. 39, 321 S.E.2d 69 (1984). *Contra* Forinash v. Daughetry, 697 S.W.2d 294 (Mo. App. 1985). In other words, the *Donahue* equal opportunity doctrine, as applied by the courts, provides a buy-out remedy in only a very narrow band of cases.

proof of high-handed, egregious conduct by a dominating shareholder. In recent year, however, judges have been more willing than in the past to order a buy-out or other less severe remedy although the case is cast as an involuntary dissolution action.

Even though judges have shown more flexibility in the types of relief they award, they still require substantial evidence of serious wrongdoing by one side or the other as a precondition to granting relief. A judge is unlikely to grant dissolution or any other relief where the proof shows mere policy differences or transitory grievances unaccompanied by evidence of protracted oppressive action or other improper conduct.[283] This is particularly true in situations where the plaintiff's own actions have caused or contributed to the dissension that underlies the lawsuit. For example, dissolution has been denied in several cases where a minority shareholder was dismissed for cause or engaged in some other improper conduct.[284] As was stated in the leading case of *In re Kemp & Beatley, Inc.*:

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[283] See the discussion of *In re* Dubonnet Scarfs, Inc., 105 App. Div. 2d 339, 484 N.Y.S.2d 541 (1985) and Coduti v. Hellwig, 127 Ill. App. 3d 279, 82 Ill. Dec. 686, 469 N.E.2d 220 (1984) *supra* notes 235-44 and accompanying text. This result is reinforced (1) by statutes that seem to require proof of oppression directed against the shareholder, (2) the "fault" basis that underlies breach of fiduciary duty claims, and (3) the allocation of the burden of proof to the plaintiff in intra-shareholder dispute litigation. *See, e.g.*, Meiselman v. Meiselman, 309 N.C. 279, 307 S.E.2d 551 (1983); Jaffe Commercial Finance Co. v. Harris, 119 Ill. App. 3d 136, 74 Ill. Dec. 722, 456 N.E.2d 224 (1983).

[284] *See* Capitol Toyota, Inc. v. Gervin, 381 So. 2d 1038 (Miss. 1980)(dismissal for cause); Exadaktilos v. Cinnaminson Realty Co., 167 N.J. 141, 400 A.2d 554 (1979)(incompetence); Mardilos v. Arger, 116 Misc. 2d 1028, 457 N.Y.S.2d 371 (1982)(shareholder and sons, who were also employees of the corporation, surreptitiously started up a competing business). Perhaps the most flagrant case is Smith-Shrader Co. v. Smith, 136 Ill. App. 3d 571, 91 Ill. Dec. 1, 483 N.E.2d 283 (1985) where a fifty percent shareholder, after a policy dispute with the other fifty percent shareholder, enticed the corporation's customers to do business with him in a new competing corporation. When sued for breach of fiduciary duty and tortious interference with business relations, he counterclaimed for involuntary dissolution. Not only did the trial judge dismiss the involuntary dismissal claim, but he also authorized a forfeiture of all salary recieved by the competing shareholder from the corporation after he began negotiating with its customers, imposed a constructive trust on all profits made by the competing corporation, enjoined the shareholder and his new corporation from doing any business with the customers of his former employer for five years, and awarded attorneys' fees and punitive damages to the other shareholder.

Sometimes courts have awarded limited relief in these types of cases. Gimpel v. Bolstein, 125 Misc. 2d 45, 477 N.Y.S.2d 1014 (1984), discussed *supra* notes 201-210 and accompanying text is an example. *See also* Wolff v. Wolff, 67 N.Y. 638, 499 N.Y.S.2d 665, 490 N.E.2d 532 (1986)(buy-out of a shareholder who had misappropriated corporate property and started a competing business affirmed); Mardikos v. Arger, 457 N.Y.S.2d 371 (corporation ordered to continue paying plaintiff the same salary and other benfits as the other two shareholders so long as the plaintiff ceased to engage in competition with the corporation; and plaintiff's sons ordered to be rehired by the corporation if they ceased competition). *Cf.* Exadaktilos v. Cinnaminson Realty Co., Inc., 167 N.J. 140 (although involuntary dissolution was denied on the grounds the plaintiff's employment had been properly terminated, the case was remanded for a hearing on other grievances which might justify some relief).

> [t]he purpose of th[e] 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.[285]

The probability that courts will render just decisions in cases involving close corporation shareholder dissension will be enhanced if the statutory framework for such suits is improved. Three types of reforms are needed.

First, oppression or some equivalent term such as unfairly prejudicial conduct should be included in every involuntary dissolution statute.[286] The growth in the number of cases decided on oppression grounds in recent years is phenomenal.[287] The increased acceptance of the frustration of reasonable expectations doctrine as the basis for a finding of oppression is a very significant development in corporate law.[288] This doctrine is particularly effective in squeeze-outs where a shareholder who reasonably expected to be permanently employed by the corporation is fired without cause, the corporation pays little or no dividends, and there is no contractual buy-out agreement that will enable the shareholder to liquidate his or her shares. The reasonable expectations doctrine will continue to play an important role in future oppression cases of all types.[289]

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[285] 64 N.Y.2d 63, 74, 484 N.Y.S.2d 799, 806, 473 N.E.2d 1173, 1180 (1984). *See also In re* John J. McClure Agency, Inc., 15 Pa. D & C3d 677, 680 (Pa. Super. 1980)("The evidence shows that a deadlock exists, but has been entirely caused by petitioner. Petitioner cannot simply cause a deadlock for the sole purpose of dissolving an otherwise viable and prospering corporation.") Frequently, the equitable doctrine of "unclean hands" will be asserted by the defendants against the plaintiff. The courts have generally held that this doctrine will bar relief only when the plaintiff's wrongdoing amounts to fraud or bad faith against the corporation or other shareholders in the transactions leading to the lawsuit. *See, e.g.*, Knaebel v. Heiner, 663 P.2d 551 (Alaska 1983); Jaffe Commercial Finance Co. v. Harris, 119 Ill. App. 3d 136, 456 N.E.2d 224 (1983)(evidence indicated that the plaintiff, when the other two shareholders refused to give in to his demands respecting a proposed merger, had threatened to file a dissolution suit and told the other two shareholders the suit would have a chilling effect on the corporation's lines of credit).

[286] *See supra* notes 42-61, 245-54 and accompanying text.

[287] *See* O'NEAL'S OPPRESSION OF MINORITY SHAREHOLDERS, *supra* note 1, p. iii.

[288] *See supra* notes 47-55 and accompanying text.

[289] At the present time much of the rationale for the reasonable expectations doctrine has been based on analogizing close corporations to partnerships. This analogy was used in Ebrahimi v. Westbourne Galleries, Ltd., [1972] 2 All E.R. 492 (H.L.), the first case to formally adopt the reasonable expectations theory. The partnership analogy was also used

Courts in states that do not authorize involuntary dissolution for

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to justify the imposition of a strict fiduciary duty on close croporations shareholders in the famous American case of Donahue v. Rodd Electrotype Co. of New England, Inc., 367 Mass. 578, 328 N.E.2d 505 (1975), discussed *supra* notes 45-46 and accompanying text and note 282.

Although it is helpful in describing the necessity for a harmonious relationship between the shareholders who are actively engaged in the day-to-day management of a closely held corporation, the partnership analogy is incomplete and can lead to undesirable results. *See generally* Easterbrook & Fischel, *Close Corporations and Agency Costs*, 38 STAN. L. REV. 271, 297-99 (1986); Hillman, *The Dissatisfied Participant in the Solvent Business Venture: A Consideration of the Relative Permanence of Partnerships and Close Corporations*, 67 MINN. L. REV. 1, 63-75 (1982); Note, *Relief to Oppressed Minorities in Close Corporations: Partnership Precepts and Related Considerations*, 1974 ARIZ. ST. L. REV. 409.

For example, under the Uniform Partnership Act any general partner can dissolve a partnership at any time with or without cause. The dissolving partner may be liable for damages to his fellow partners and may not be able to recover any goodwill value of his interest if the remaining partners agree to continue the business. Nevertheless he or she has the right to force a technical dissolution at will and if the business is continued it is technically a new partnership. *Uniform Part. Act* §§ 31, 37-40 (1914). This dissolution right of general partners is based on the unlimited liability of each partner for the acts of all other partners in the conduct of the business, contrary to a corporation where limited liability of a shareholder is a fundamental precept. Employing the partnership dissolution concept to all close corporations would in effect give every shareholder a cash-out "put" and make dissolution the norm rather than the exception, contrary to all existing case law. The inappropriateness of such a result was recently recognized in *In re* a Company, [1983] 2 All E.R. 854, 860-62 (Ch. Div.) where the court held that shareholders in a close corporation do not expect they will have the dissolution rights of a partner, but on the contrary reasonably expect that they will have to apply to a court for relief and will be granted dissolution only if they have been wronged and there is no other appropriate relief available.

Note also that the death of a general partner automatically dissolves a general partnership. *See Uniform Part. Act* § 31(4)(1914). If this rule were applied to close corporations, the estate of a deceased shareholder could automatically have the corporation dissolved if the decedent's shares were not purchased even though there was no buy-out agreement and the shareholders had never purchased the shares of any other shareholder. Even the most liberal states like Massachusetts have rejected this result. *See* Goode v. Ryan, 397 Mass. 85, 489 N.E.2d 1011 (1986). *See also supra* note 282. In this connection, giving a shareholder a no fault cash-out/dissolution right based on a partnership model as advocated by some commentators (*see* Hetherington & Dooley, *supra* note 145, at 32-62) would in effect give shareholders in a closely held corporation greater rights than shareholders in a publicly held corporation. A shareholder of IBM can sell his shares on the open market; but he or she cannot force IBM to buy those shares or be liquidated.

There are also other important fundamental differences between partnerships and corporations. By statute, unless the partnership agreement otherwise provides, each general partner is entitled to participate in the management of a partnership and votes are cast on a per capita rather than a per share basis. *Uniform Part. Act* § 18(e), (h) (1914). While equal management rights may be the "reasonable expectation" of the shareholders who hold an equal number of shares and intend to be active in the management of the corporation, they are not "reasonable expectations" for passive inactive shareholders. *See In re* Fildes Bros., Ltd., [1970] 1 All E.R. 923, 925-28 (Ch. Div.)(refusal to hire brother who for many years had been a passive shareholder not actionable).

From a legal theory standpoint, a firmer foundation for the reasonable expectations doctrine is basic contract law principles under which a court will fill in "missing" terms once

minority shareholder oppression have often dismissed the action unless the facts can somehow be construed to constitute deadlock. Some courts, however, have granted relief on other grounds, principally breach of fiduciary duty. For reasons discussed in Part IV, however, involuntary dissolution suits are often a more satisfactory manner in which to litigate all of the issues involved.[290]

Second, the statutes should specify a laundry list of other types of relief that can be granted by a judge; and in the case of a court-ordered buy-out, should give the judge the authority to authorize installment sales, a covenant not to compete and other terms normally found in a close corporation contractual buy-out agreement.[291] The deficiencies in many of the existing buy-out statutes referred to in Part II need to be corrected.[292] The statutes should also deal specifically with the allocation of costs, including attorneys' fees and experts' fees, and prejudgment interest.[293]

Finally, close corporation relief statutes should be recast so that involuntary dissolution is specified to be the last resort remedy rather than the primary relief. Most of the existing statutes, including those specifically authorizing other types of relief, are entitled "Judicial

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the judge is convinced the parties intended to have a binding contract. *See* RESTATEMENT (SECOND) CONTRACTS §§ 110-50 (statute of frauds), 205-23 (duty of good faith and fair dealing, usage of trade and course of dealing and parol evidence)(1984). *See also id.* § 90 (detrimental reliance). This "gap filling" technique is particularly evident in the Uniform Commercial Code. *See, e.g.*, U.C.C. §§ 2-201, 2-204, 2-208. *See generally*, Hawkland, *Sales Contract Terms Under the UCC*, 17 U.C.C.L.J. 195 (1985). By analogy, parol evidence (the oral "reasonable expectations") as well as course of dealing and course of performance should be admissible to supplement the basic written "agreement" among the shareholders (the articles of incorporation, bylaws, any shareholder's agreement, etc.). *Cf.* U.C.C. § 1-201(3)("agreement" means "the bargain of the parties in fact as found in their language or by implication from other circumstances including course of dealing or usage of trade or course of performance . . . .").

The "contract" theory has been used by many courts to enforce oral agreements between shareholders in a closely held corporation independently of the reaonable expectations theory. See the cases cited *supra* note 51. *See also, e.g.*, Wasserman v. Rosegarden, 84 Ill. App. 3d 713, 406 N.E.2d 131 (1980)(oral agreement that salaries and dividends would be equal even though stock ownership was unequal enforced); Schraft v. Leis, 236 Kan. 28, 686 P.2d 685 (1984)(oral agreement with respect to salaries enforced). The shareholder seeking to enforce the oral agreement would have the burden of proving the existence of the agreement by clear and convincing evidence. *See, e.g.*, Meiselman v. Meiselman, 309 N.C. 279, 307 S.E.2d 551 (1983); Allen v. Royale "16", Inc., 449 So. 2d 1365 (La. App. 1984); Jaffe Commercial Finance Co. v. Harris, 119 Ill. App. 3d 136, 74 Ill. Dec. 722, 456 N.E.2d 224 (1983). Several courts have held that the plaintiff failed to meet this burden of proof. *See, e.g.*, Allen v. Royale "16", Inc., 449 So. 2d 1365 and Jafee v. Commercial Finance Co. v. Harris, 119 Ill. App.3d 136.

[290] *See supra* notes 255-72 and accompanying text.

[291] *See supra* notes 68-74, 101-11 and accompanying text.

[292] *See supra* notes 75-117 and accompanying text.

[293] *See supra* notes 93-100 and accompanying text.

Dissolution."[294] Given this framework, many courts have taken the overly restrictive position that no relief of any kind can be granted unless the court was satisfied that dissolution was justified.[295] This direct linkage was broken in the 1980 English Companies Act with the adoption of Section 75, which replaced former Section 210.[296] The tiered remedial scheme in the Model Business Corporation Act Statutory Close Corporation Supplement, which is described in Section II, also accomplishes this result.[297]

Another reason for eliminating the existing statutory emphasis on involuntary dissolution is to reduce somewhat that threat to the majority shareholders presented by suits demanding involuntary dissolution. Faced with the tax and other adverse consequences of a potential liquidation, the majority may feel compelled to settle with the plaintiff on terms that, in effect, amount to minority oppression.[298] If this is true, a persuasive argument can be made that the present statutory formulation gives the minority too powerful a bargaining weapon to hold over the heads of the majority. Making dissolution by statute the last resort remedy to be ordered only if all other possibilities of resolving the dissension have failed changes somewhat the relative bargaining position of the parties. Since dissolution will be a possibility, however, a minority shareholder will still have effective bargaining leverage. In addition, a court can use the threat of dissolution as well as the authority to award attorneys' fees and other costs as leverage to assure that the majority shareholders bargain in good faith. Moreover, a court can also use its discretion to award attorneys' fees and costs as a means of discouraging frivolous or groundless suits by minority shareholders.

Even with these statutory improvements, litigation to resolve close corporation shareholder dissension will continue to be expensive, time-

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[294] *See, e.g.*, MBCA, *supra* note 31 § 14.30; S.C. CODE ANN. § 33-21-150 (Law. Co-op Supp. 1985)("Dissolution Pursuant to Court Order").

[295] This judicial attitude was particularly evident in the interpretation of Section 210 of the 1948 English Companies Act. *See* O'NEAL'S OPPRESSION OF MINORITY SHAREHOLDERS, *supra* note 1, § 10:12.

[296] ENGLISH COMPANIES ACT 1980, § 75. *See* O'NEAL'S OPPRESSION OF MINORITY SHAREHOLDERS, *supra* note 1, § 10:13.

[297] *See MCBA Stat. Close Corp. Supp.*, *supra* note 69, §§ 41-43, discussed *supra* notes 69-74 and accompanying text. Texas and Wisconsin (which has adopted the MBCA Statutory Close Corporation Supplement) have adopted statutes allowing direct actions against close corporations and their shareholders without having to prove specific grounds for involuntary dissolution. *See* TEX. BUS. CORP. ACT. ANN. art. 12.51-.54 (Vernon 1986 Supp.); WIS. STAT. § 180.995(19)(Supp. 1985).

[298] *See* Hetherington, *The Minority's Duty of Loyalty in Close Corporation*, 1972 DUKE L.J. 921. Although rare, cases granting relief for minority oppression of majority shareholders do exist. *See, e.g.*, Smith v. Atlantic Properties, Inc., 12 Mass. App. 201, 422 N.E.2d 798 (1981)(minority shareholder who refused to vote in favor of dividend distributions assessed personally the accumulated earnings tax penalties imposed on the corporation).

consuming and a high risk venture for both sides.[299] Neither side can predict the eventual outcome; and even if the plaintiff prevails, the relief ordered by the judge may be different from what the plaintiff wanted.[300] Furthermore, the likelihood of reversal on the merits on appeal is small because of the broad discretion vested in the trial judge. This uncertainty provides an incentive for both sides to negotiate a settlement before the trial judge issues a final order. An astute judge can and should facilitate this settlement process.

The various non-litigation dispute resolution devices described in part I also present potential problems.[301] A broad buy-out arrangement covering most situations that are likely to create dissension is the most logical solution, but in many situations will be impractical because of the expense.[302] The alternative involving third parties acting as decision makers in place of the shareholders and directors also present serious practical problems.[303] Perhaps the best solution from a corporate planning perspective is to utilize as broad a buy-out as the corporation and shareholders can reasonably afford combined with arbitration as a prerequisite for any court action.[304]

When a major intra-corporate dispute arises, the best advice a lawyer representing the majority shareholders can give is to recommend that they refrain from taking any action that can give ammunition to the minority to claim oppression or fraud.[305] A proper paper trail justifying

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[299] *See, e.g.*, Orchard v. Covelli, 590 F. Supp. 1548 (W.D. Pa. 1984)(buy-out price of $354,447 plus seven years of prejudgment interest totalling $163,690); Stefano v. Coppock, 705 P.2d 443 (Alaska 1985)(buy-out price of $32,000, prejudgment interest from 1974 of $23,431 plus attorneys' fees of $20,000).

[300] *See, e.g.*, Schaub v. Kortgard, 372 N.W.2d 427 (Minn. App. 1985)(plaintiff wanted to buy the defendant's stock by the court ordered him to sell his stock to the defendant).

[301] *See supra* notes 2-26 and accompanying text.

[302] To provide protection against all contingencies, the buy-out agreement would have to cover death, permanent disability, termination of management responsibilities, divorce and bankruptcy. *See* ORGANIZING A SMALL BUSINESS ENTITY, *supra* note 2, § 5.04(c)(3). Depending on whether the buy-out plan created a mandatory purchase right or merely an option to purchase, the potential financial strain on the corporation and remaining shareholders of such a plan could be tremendous.

[303] *See supra* notes 2-19 and accompanying text.

[304] Depending on the wording of an arbitration clause, the filing of an involuntary dissolution suit in and of itself may not trigger arbitration. *See e.g.*, *In re* Cohen, 183 Misc. 1034, 52 N.Y.S.2d 671 (1944), *aff'd mem.*, 269 App. Div. 663, 53 N.Y.S.2d 467 (1945)(filing of the suit is not a "dispute"). If the underlying dispute is one that is subject to arbitration, courts will generally stay the dissolution proceeding pending the outcome of the arbitration. *See, e.g.*, Lehman v. Sage Metal Trading Corp., N.Y.L.J. Dec. 23, 1985, p. 11, col. 6; *In re* Siegel, 80 Misc. 2d 255, 362 N.Y.S.2d 897 (1974). *See generally* O'Neal, CLOSE CORPORATIONS, *supra* note 15, § 9.18; G. Wilner, DOMKE ON COMMERCIAL ARBITRATION, § 13:02 (Rev. ed. 1984).

[305] The absence of serious disciminatory action by the majority shareholder against a minority shareholder after the dissension arises has been a major factor in several cases. *See, e.g.*, Coduti v. Hellwig, 127 Ill. App. 3d 279, 469 N.W.2d 220 (1984) discussed *supra*

dismissal of a shareholder as an employee, officer, and director for legitimate business reasons, (for example, incompetency), is extremely important. A careful review of compensation and dividend policies with the aim of being "fair" to the dismissed shareholder is also important. Any substantial increase in the salaries and other benefits paid to the remaining active shareholders after dismissing a shareholder employee should be avoided unless the increases are clearly warranted. Finally, it is very important to comply fully with all corporate formalities such as notices of meetings. Allowing the minority reasonable access to all corporate books and records required to be available for inspection is also important.

Convincing the majority to make a "fair" offer to purchase the shares of a disgruntled minority shareholder within a reasonable amount of time after it is clear the dispute cannot be amicably resolved[306] is often difficult, but in the long run may be in the best interests of all the shareholders. It is certainly better than dissolution, especially if the corporation is financially successful. It is also increasingly the most likely remedy other than dissolution that a court will impose if litigation ensues.[307] So why risk a potential dissolution order, the time and expense of a dissolution suit and the potential financial harm to the corporation that can result from bitter, protracted litigation? Furthermore, a pre-litigation buy-out offer at a reasonable price can be a positive factor in the

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notes 239-44 and accompanying text. *See also* Mardikos v. Arger, 116 Misc. 2d 1028, 457 N.Y.S.2d 371 (1982)(plaintiff continued to receive the same salary and benefits as the other two shareholders and continued to have full access to the corporation's office and records); Zidell v. Zidell, Inc., 277 Or. 413, 560 P.2d 1086 (1977)(plaintiff left voluntarily after dispute and no starvation tactics were used); Iwasaki v. Iwasaki Bros.,Inc., 58 Or. App. 543, 649 P.2d 598 (1982)(plaintiff left employment voluntarily and started a competing business).

General counsel for the corporation faces some difficult conflict of interest issues in the event of shareholder dissension and litigation. *See* H. HAYNSWORTH, THE PROFESSIONAL SKILLS OF THE SMALL BUSINESS LAYWER, § 2.02 (1984). The biggest danger is the failure to realize that ethically, general counsel represents the corporation and not the shareholders individually. *Cf.* Orchard v. Covelli, 590 F. Supp. 1548 (W.D. Pa. 1984), discussed *supra* notes 216-25 and accompanying text (the court found "nothing laudable" in the lawyer's conduct but did not impose any personal liability on him for his behavior in representing both the corporation and a majority shareholder in a squeeze-out case).

[306] The possibility of a non-taxable split off or split under I.R.C. § 355 should be explored. Section 355 is often used as a means of resolving close corporation dissension. The statutory requirements, however, are quite strict. Generally, two separate businesses, each of which have been operated for five years, are necessary. *See generally* B. BITTKER & J. EUSTICE, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS ¶ 13.01-13.15 (4th ed. 1979).

[307] *See supra* notes 143-54 and accompanying text.

ultimate outcome of the case.[308] It will at the least convince a judge not to impose the plaintiffs' attorneys' fees as a sanction.[309]

Finally, a lawyer representing an aggrieved minority shareholder must carefully analyze the applicable statutes and if the facts justify an involuntary dissolution cause of action, the complaint should request that the corporation be liquidated even if some other remedy is the client's ultimate objective. Often because of statutory deficiencies or the particular facts, a complaint containing multiple causes of action will be advisable. Pleading causes of action which are not justified by the facts, however, is dangerous. Groundless pleadings are likely to have a negative effect on the trial judge and may result in sanctions.[310] If a multiple cause of action complaint is filed, the plaintiff's lawyer must be alert to any procedural differences between the various types of action and the potential impact a judgment on (or settlement of) one of the causes of action will have on the remaining causes of action.[311]

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[308] *See, e.g., In re* A Company [1983] 2 All. E.R. 854 (court ordered shares valued as of the date of the court's judgment rather than the date of the oppression as a penalty for plaintiff's refusal to accept a pre-litigation offer to have the shares appraised); Baker v. Commercial Body Builders, Inc., 264 Or. 614, 507 P.2d 387 (1973)(pre-trail offer to minority shareholder at one-half book value considered positively by court in decision denying relief); O'Farrell v. Steel City Piping Co., 266 Pa. Super 219, 403 A.2d 1319 (Pa. Super. 1978)(plaintiff rejected pre-litigation book value offer). A "bad faith" offer, however, can have a negative effect on the outcome. *See* Stefano v. Coppock, 705 P.2d 443 (Alaska 1985), discussed *supra* notes 230-34 and accompanying text.

[309] *Cf. In re* A Company, *supra* note 308; Moore v. Carney, 84 Mich. App. 399, 269 N.W.2d 614 (1978)(court denied prejudgment interest because the plaintiff had rejected a pre-trial offer for the same price ultimately determined to be the fair price).

[310] *See* Orchard v. Covelli, 590 F. Supp. 1548, 1550 (W.D. Pa. 1984), discussed *supra* notes 216-25 and accompanying text where the court found "that the vast majority of Mr. Orchard's claims are without merit and that the law does not recognize a right of recovery." The court also observed that close corporation intra-shareholder dispute cases require a "careful balance of equities" and that "[w]e are constrained to note here that the weight of our responsibility has not been lightened by the manner in which plaintiff's counsel presented his case." For a discussion of the increase in judicially imposed sanctions for frivolous pleadings and related abuses, see, *e.g.*, American Bar Association Section on Litigation, SANCTIONS: RULE 11 AND OTHER POWERS (1986).

[311] *See supra* notes 256-74 and accompanying text. *See also* Miller v. Ruth's of North Carolina, Inc., 69 N.C. App. 672, 318 S.E.2d 2 (1984)(buy-out order barred other causes of action including a derivative action); McLeod v. Stevens, 617 F.2d 1038 (4th Cir. 1980)(election of remedies rule applied to deny recovery of punitive damages). *Compare* Humes v. Margil Ventures, Inc., 174 Cal. App. 3d 486, 220 Cal. Rptr. 186 (1985)(suit for involuntary dissolution and independent administrative action for termination of a contract held not to be inconsistent causes of action requiring an election of remedies).