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67. Horlick & deBusk, *Dispute Resolution Under NAFTA*, 27 J. WORLD TRADE 21,31 (1993).

68. Huntington, supra note 19 at 432.

69. Id., see note 177.

70. Lowenfeld, supra note 24 at 620.

71. Moyer, supra note 6 at 721.

72. Id., at 724.

73. Alford, *Introduction: The North American Free Trade Agreement and the Need for Candor* 34 HARV. INT'L L.J. 293 (1993).

74. Moyer, supra note 6 at 714.

75. Report of Joint Working Group of the American Bar Association et al, 34 HARV. INT'L L.J. 831,834 (1993).

76. The CFTA required the Parties to establish a formal Working Group to address the issue of harmonization and provided that failure to implement a new regime within seven years would allow either Party to terminate the Agreement. (CFTA Article 1906) NAFTA is less stringent, simply requiring the Parties to consider the "potential" to develop substitute measures. (NAFTA Article 1907-2).

RELIEF FOR MINORITY SHAREHOLDERS- THE NEW YORK SOLUTION*

by

Peter M. Edelstein**

Introduction

When teaching "corporations," have you ever felt that there was a larger than usual disparity between the subject as taught and the probable future experiences of our students? The classic features of a corporation--limited liability, perpetual duration, ease of transferability of interest, and centralized management, seem so remote from the intimate, close corporations many of our students are likely to deal with.

After graduation, A. Abbie, in the front row, B. Benny, who sits behind her and C. Cindy in the back, may form "ABC Cookie Corp.", to exploit C. Cindy's recipe for chocolate chip cookies. They will invest their life's savings, devote all of their time and efforts to the success of the venture, and dream of lifetimes of happy employment including handsome compensation packages, bonuses and benefits. They may even look forward to the day they will sell their interests, retire to Hawaii and be remembered as the latest incarnations of "Famous Amos."

They will each be shareholders, board members, and officers. They will probably not conduct regular board meetings, have annual shareholder's meetings,

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keep minutes, nor observe any but the minimum corporate formalities; and those only when threatened by their lawyer or accountant.

To these three individuals, the classic corporate features we taught them are mostly irrelevant. As to perpetual duration, they know that they can dissolve the corporation at any time and, if they are not good corporate citizens, the state may dissolve it for them. As to ease of transferability of their interests, they are concerned with the opposite--restricting the transfer of shares, and they will probably execute a shareholder's agreement to that effect. As to centralized management, they each have the powers and rights of shareholders, officers and directors, but are not really sure what the differences are, or why they exist, because they do everything together anyway.

A. Abbie, B. Benny and C. Cindy probably consider themselves to be "partners." The corporate form of business may have been selected only for its supposed insulation from personal liability. But even that attribute is mostly imaginary today in matters of contract liability to lending institutions, landlords and major vendors, due to the routine requirement of personal guarantees.

ABC Cookie Corp. may operate harmoniously for years, with the individuals making all business decisions by persuasion of the majority. When, however, A. Abbie and B. Benny get married, and pool their interests to consistently polarize the two of them on one side of each issue and C. Cindy on the other, C. Cindy could suffer dramatically. Now, governance by the majority means that C. Cindy has no effective voice. If the relationship deteriorates to the point that C. Cindy is no longer able or allowed to participate in the business of the corporation, she may experience the loss of her employment, the loss of her compensation, the loss of any return on her investment and the loss of all of her reasonable expectations for her future. A bad novelist might say that "all of her dreams were shattered."

Just as we, as instructors, sense that most of our students will not become CEO's of large, publicly traded corporations (and that, therefore, lectures relating exclusively to such corporations may not be entirely relevant to their business future), the legislature and the courts of the State of New York have acknowledged that shareholders in close corporations have special needs.[1]

New York recognizes the practical difference between being a shareholder in a large publicly held corporation and being a shareholder in a close corporation, particularly in instances of shareholder oppression. All shareholders may pursue the traditional remedies of direct or derivative actions against the corporation and the

board of directors to remedy perceived wrongs. Shareholders in publicly traded corporations also have the ability to become instantly liquid. The aggrieved shareholder can dispose of his or her shares by selling them for market value through a stock exchange or stock market transaction. To shareholders in a close corporation, instant liquidity may not be available and the other remedies may not be practical. This paper discusses the statutory cause of action for "oppression" by the corporate majority against the minority, what behaviors constitute oppression and two defenses recently raised by a defendant-majority shareholder in an oppression case in New York County.

A Cause Of Action For Oppression

The New York legislature, in 1979, reacting to section 97 of the ABA-ALI Model Business Corporation Act (1972 ed.) and to the statutes already passed in twelve other states,[2] adopted Business Corporation Law section 1104-a[3] to afford certain protections to minority shareholders, in closely held corporations, who were oppressed by the majority.

BCL section 1104-a (and its corollary, BCL section 1118)[4]."... created remedies for minority shareholders of close corporations and may be considered legislative recognition of the fact that the relationships among shareholders of such corporations closely approximated that among partners."[5] Section 1104-a(a) offers to minority shareholders of close corporations the weighty remedy of involuntary dissolution. It provides, in relevant part:

> "The holders of twenty percent or more of all outstanding shares of a corporation...no shares of which are listed on a national securities exchange or regularly quoted in an over-the-counter market...who are entitled to vote in an election of directors may present a petition of dissolution on one or more of the following grounds: (1) The directors or those in control of the corporation may have been guilty of illegal, fraudulent or oppressive actions toward the minority shareholders..."[6]

"Oppression" is not defined in the BCL. Professor F. Hodge O'Neal, an authority on "squeeze-outs" of minority shareholders, formulated a test for "oppression" which was included in the legislative materials of the statute's cosponsors in 1979.[7] In describing the need for such a test, Professor O'Neal stated:

> "Many participants in closely held corporations are `little people,' unsophisticated in business and financial matters. Not uncommonly a participant in a closely held enterprise invests all his assets in the business with an expectation, often reasonable under the circumstances even in the absence of an express contract, that he will be a key employee in the company and will have a voice in business decisions."[8]

The "reasonable expectations" test has been the benchmark for determining oppressive actions from the first New York case, in 1980, to deal with BCL section 1104-a,[9] and has been described as follows: A shareholder who reasonably expected that ownership in the corporation would entitle him or her to a job, a share of corporate earnings, a place in corporate management, or some other form of security, would be oppressed in a very real sense when others in the corporation seek to defeat those expectations and there is no effective means of salvaging the investment.[10]

In the seminal case of In the Matter of Topper,[11] the Court found "oppression" by the controlling shareholder, based on the following facts: "...[B]usiness...flourished in the brief one-year period during most of which Petitioner Topper has actively participated," [12] "...Petitioner Topper associated himself with [the other two shareholders and the corporations] in the expectation of being an active participant...,"[13] "Petitioner put his life savings into the venture."[14] [Petitioner] executed personal guaranties..."[15] "...[T]he majority shareholders...discharged petitioner as an employee, terminated his salary...removed him as an officer...and changed the locks on the corporate offices to exclude him."[16]

The Court held, based on the foregoing facts: "...[R]espondent's actions have severely damaged petitioner's reasonable expectations and constitute a freeze-out of petitioner's interest; consequently, they are deemed to be `oppressive' within the statutory framework."[17]

Since the Topper decision, the courts of New York have consistently found "oppression" within the meaning of BCL section 1104-a by application of the "reasonable expectations" test. Minority shareholders have been granted relief from the oppression of the majority in the following circumstances:

• Petitioner, a thirty-five percent shareholder, was expelled from any role in the corporation and removed as an officer and a director.[18]

• Petitioner, a one-third shareholder with two other shareholders, was frozen out of active operations of the corporation. There existed no shareholder's or any other written agreement with respect to the operation of the corporation, there were no bylaws and many organizational formalities were ignored.[19]

• Petitioners, both long term employees (one for forty-two years, the other for thirty-six years) had invested capital in the corporation. After leaving, they were "frozen out." Their experience had been that when with the company they received distributions of the company's earnings. After they left, they received nothing. The court held: " When the majority shareholders of a close corporation award *de facto* dividends to all shareholders except a class of minority shareholders, such a policy may constitute `oppressive actions' ..."[20]

• Petitioner, actively engaged in family business, was discharged as an officer and employee (of all the family corporations), locked out of the building and threatened with criminal prosecution if he trespassed on any of the corporate properties.[21]

• Petitioner joined the corporate venture pursuant to an understanding that he would be provided with salaried employment to continue as long as the corporation existed; his salary was terminated.[22]

• Petitioner-employee, a twenty-five percent shareholder and employee of a family-owned corporation was terminated, was denied entry to the corporate office by use of a padlock and was denied further salary and dividends.[23]

• Petitioner, a one-third shareholder and employee, was suspected of: expense account irregularities, making generous "gifts" to clients, double-billing the corporation for the same expense, holding himself out to be the president (which he was not), and engaging in a side business (which may or may not have been in competition with the corporation). He was terminated, the locks were changed, he was removed as an officer and director.[24]

In all of the foregoing illustrations, the common theme was the conduct of the majority that substantially defeated the expectations of the minority that were reasonable under the circumstances. The disappointment of the minority shareholders constituted oppression.[25]

Dissolution Or Buy-out

Section 1104-a, by its terms, affords the "oppressed" shareholder with a cause of action for involuntary dissolution. This may or may not be a satisfactory remedy under the particular circumstances. However, when the oppressed minority shareholder combines the threat of dissolution with BCL section 1118, a weapon of substantial practical utility is created.[26] That section provides a court sanctioned mechanism for dispute resolution far broader than an order for dissolution alone. In all but the most unusual circumstances, the minority shareholder wants to be free from the oppressive majority, to cash out, and to be able to invest and work elsewhere. The statutory remedy of dissolution under section 1104-a alone, may not provide the shareholder with the means or the opportunity to pursue his or her chosen career. The lawsuit may continue for years, and the book value of the shares may decrease during the process of litigation due to the distraction of management and the costs involved.[27]

Section 1118, entitled "Purchase of petitioner's shares; valuation.", provides in relevant part:

> "(a) In any proceeding brought pursuant to section eleven hundred four-a of this chapter, any other shareholder or shareholders or the corporation may, at any time within ninety days after the filing of such petition or at such later time as the court in its discretion may allow, elect to purchase the shares owned by the petitioners at their fair value and upon such terms and conditions as may be approved by the court. (b) If one or more shareholders or the corporation elect to purchase the shares owned by the petitioner but are unable to agree with the petitioner upon the fair value of such shares, the court, upon the application of such prospective purchaser or purchasers, or the petitioner may stay the proceedings brought by pursuant to section 1104-a of this chapter and determine the fair value of the petitioner's shares as of the day prior to the date on which such petition was filed, exclusive of any element of value arising from such filing..."

The result of these two sections, 1104-a and 1118, is to provide the oppressed minority shareholder with more than just a remedy for involuntary dissolution. Together, they give the shareholder the power to negotiate, with judicial imprimatur, to cause the majority to seriously consider buying out the minority. Failure to do so raises the possibility of forced dissolution or forced purchase of the minority shares, with the court determining the value *as of the date of the petition.*

This additional statutory remedy not only broadens the scope of 1104-a, but effectively changes its nature from a rifle approach to dissolution to a shotgun approach to dispute resolution, which can be used to effectuate settlement of a myriad of shareholder questions.

No Conflict With The Employment At-Will Doctrine

New York retains the doctrine of employment at-will by which an employer, in the absence of an agreement to the contrary, may terminate an employee at any time for cause or for no cause.[28]

An imaginative defendant-majority shareholder, in a case now before the Supreme Court, New York County, In the Matter of The Application of Michael P. Lyons,[29] asserted as a defense, that the existence of the employment at-will doctrine precluded the plaintiff-minority shareholder from alleging "oppression" under section 1104-a. In that case, the controlling shareholder summarily dismissed the petitioner-minority shareholder as an employee and removed him as an officer and director, all without prior notice or warning. The locks on the doors of the corporation were changed and the petitioner-minority shareholder was denied compensation. The theory of the defendant-majority shareholder amounted to an argument that because under New York law, an employee at-will can be terminated at any time, any termination cannot amount to oppression. This defense ignores the gravamen of section 1104-a. The section does not prohibit the termination of the shareholder-employee, but rather, it provides a remedy for the oppression of that shareholder-employee. It is not the loss of the employment *per se* that is central to the spirit of the statute, but the loss of one's reasonable expectations for one's future under the totality of the circumstances.

The courts in New York, weighing the right to terminate an employee against the right of that employee to be free from oppression, have addressed the issue in the form of the relevance of the conduct of the terminated minority shareholder, and have held: "Whether the Controlling Shareholder discharged petitioner for cause or in their good business judgment is irrelevant."[30]

In one case,[31] the petitioner-minority shareholder had stolen from the corporation. The court, in applying BCL section 1104-a, went as far as to pronounce: "Even Cain was granted protection from the perpetual vengefulness of his fellow man (Genesis 4:12-15)... The Court is not without jurisdiction to fashion a remedy here."[32]

In a similar case, the court, applying BCL section 1104-a, cited Topper[33] and held: "...'unclean hands' is not an automatic bar..." to relief under BCL section 1104-a. [34] "Only when a 'minority shareholder whose own acts, made in bad faith and undertaken with a view toward forcing involuntary dissolution, give rise to the complained-of oppression' should relief be barred."[35]

In a recent Putnam County case, referred to above, Judge Dickinson was faced with a petitioner-minority shareholder about whom the controlling shareholder alleged expense account irregularities, the giving of unauthorized "gifts," double-billing, holding himself out as president of the corporation, (which he was not), conducting a "side business" with his brother-in-law and theft of business. The Court citing Topper[36] and similar cases, held: "The...Petitioner may not be prevented from seeking dissolution merely because he is guilty of one or more of the charges made against him."[37]

Corporate Informality Is Not Inconsistent With The Application Of Bcl Section 1104-a

The defendant-majority shareholder, in the Lyons[38] case, also defended on the grounds that the minority shareholder did not have a written employment agreement, nor did there exist records of the corporation to support the claim of oppression; presumably on the theory that a corporation operated in less than text book fashion should be free to oppress its minority shareholders.

The informality with which closely held corporations operate, has long been held not to bar application of BCL section 1104-a. On the issue of formality, as on the issue of oppression, the nature of close corporations has been recognized to be substantially different from large or publicly held corporations.

Professor O'Neal commenting on the application of BCL section 1104-a states: "Not uncommonly a participant in a closely held enterprise invests all his assets in the business with an expectation, often reasonable under the circumstances *even in the absence of express contract*, that he will he a key employee in the company and will have a voice in business decisions"[39] (emphasis added).

The courts in New York have recognized that corporate formalities are frequently ignored in close corporations. In finding for the petitioner, it has been held: "The parties did not enter into any shareholders' or any other written agreement with respect to the operation of the Corporation and many organizational

formalities...do not seem to have taken place prior to the institution of this proceeding."[40]

"The failure to make [the petitioner] a shareholder until April 1974, merely reflects *the informality with which close corporations are frequently run and the informality which [BCL] section 1104-a is intended to* remedy[41] (emphasis added).

Conclusion

The promulgation of BCL sections 1104-a and 1118, and court decisions thereunder, are legislative and judicial recognition that participants in close corporations should not be governed by the classic rules applicable to large publicly traded corporations. Special rules apply to shareholders in close corporations, many of whom view themselves as partners for the purpose of governance, and as shareholders for the purpose of enjoying the real or imagined benefits of limited liability.

Section 1104-a has provided minority shareholders with a serious weapon--the threat of involuntary dissolution. In practice, section 1118 has converted section 1104-a into a powerful tool to provide an equitable resolution to fundamental problems between or among shareholders. By application of the two sections, a negotiated settlement between the minority and the majority is likely to result.

ENDNOTES

[1] National recognition of the disparity between the classic corporate norms and the perceived relationship between or among shareholders in a closely held corporation is evidenced by the recent trend by many states to adopt enabling legislation for a business entity known as the *limited liability company*. This new business unit offers the members a partnership atmosphere in daily operations together with the corporate feature of limited liability. As of this writing, legislation authorizing this modern business creature has been adopted in about twenty states. *See* Jerome Kurtz, The Limited Liability Company and the Future of Business Taxation: A Comment on Professor Berger's Plan, 47 The New York University Tax Law Review 815, (1992).

[2] 2. *See* In the Matter of Myron F. Topper, *et al.*, Petitioner, v. Park Sheraton Pharmacy, Inc., Respondent, 107 Misc. 2d 25; 433 N.Y.S. 2d 359 (1980); *See* Report for the Joint Legislative Committee to Study Revision of the Corporation Laws (Consultant Report, No. RR-70, Joint Legis. Comm. to Study Rev. of Corporation Laws)(1958).

[3] Effective June 11, 1979, pursuant to L. 1979, c. 217, §4.

[4] BCL §1118 "Purchase of petitioner's shares; valuation." Effective June 11, 1979, pursuant to L. 1979, c. 217, §4.

[5] See InThe Matter of Gordon & Weiss, 32 A.D. 2d 279; 301 N.Y.S. 2d 839. The First Department noted "It is being increasingly realized that the relationship between stockholders in a close corporation vis-a-vis each other in practice closely approximated the relationship between partners...," at 281, 842.

[6] BCL 1104-a(a).

[7] See In the Matter of Topper, supra at p. 32, 364 for a discussion of the background of the "reasonable expectations test."; *See* O'Neal, 33 The Business Lawyer 884.

[8] O'Neal, 33 The Business Lawyer 884; *See also* In the Matter of Topper, at page 33, 365.

[9] In the Matter of Myron F. Topper, et al., Petitioners, v. Park Sheraton Pharmacy, Inc., Respondent, 107 Misc. 2d 25; 433 N.Y.S. 2d 359 (1980).

[10] In the Matter of the Judicial Dissolution of Kemp & Beatley, Inc. Seymour Gardstein *et al.*, Respondents; Kemp & Beatley, Inc. Appellant, 64 N.Y. 2d 63; 473 N.E. 2d 1173; 484 N.Y.S. 2d 799 (1984), at p. 72, 1179, 805.

[11] Topper, 107 Misc. 2d 25; 433 N.Y.S. 2d 359 (1980).

[12] *Id* at p. 27, 361.

[13] *Id* at p. 27, 361.

[14] *Id* at p. 27, 362.

[15] *Id* at p. 27, 362.

[16] *Id* at p. 27, 362.

[17] *Id* at p. 27, 362.

[18] O'Donnel v. Marine Repair Services, Inc., 530 F. Supp. 1199 (1982).

[19] Gene Barry One Hour Photo Process, 111 Misc. 2d 559; 444 N.Y.S. 2d 540, (1981)

[20] Kemp & Beatley, at p. 67, 1175, 801.

[21] In the Matter of the Dissolution of Wiedy's Furniture Clearance Center, 108 A.D. 2d 81; 487 N.Y.S. 2d 901 (1985).

[22] In the Matter of John Imperatore, 128 A.D. 2d 707; 512 N.Y.S. 2d 904 (1987).

[23] In the Matter of Robert H. Burack, 137 A.D. 2d 523; 524 N.Y.S. 2d 457 (1988).

[24] Matter of Kupersmith (Caduceus Medical Publishers, Inc. , Supreme Court, Putnam County, NYLJ, Aug. 22, 1991, p.21.

[25] *See* Robert B. Thompson, The Shareholders' Cause of Action for Oppression, 48 The Business Lawyer 699 (1993), for an excellent review of the evolution of the cause of action.

[26] BCL section 1118. Buy-out may be considered a less harsh remedy; *See* Davis v. Sheerin, 754 S.W. 2d 375 (Tex CT. App. 1988).

[27] Not to be taken lightly, as to cost to the minority shareholder, in terms of time and money.

[28] *See* Martin v. New York Life Insurance Co., 148 N.Y. 117, 42 N.E. 416 (1895); for a full discussion of the development of the employment at-will doctrine in New York; *See* Minda, The Common Law of Employment At-Will in New York: The Paralysis of Nineteenth Century Doctrine, 36 Syracuse L. Rev. 939 (1985).

[29] In the Matter of the Application of Michael P. Lyons, a Holder of Forty Percent of All the Outstanding Shares of Elmrich Enterprises, Inc., d/b/a/ The Personnel Source, Petitioner, For the Dissolution of Elmrich Enterprises, Inc. d/b/a The Personnel Source, a Domestic Corporation, Supreme Court, New York County, Index Number 114991/93.

[30] In the Matter of Topper, at p.28, 362.

[31] Robert Gimpel, Plaintiff, v. Moe Bolstein et. al., Defendants; In the Matter of Dissolution of Gimpel Farms, Inc. Robert Gimpel, Petitioner; Moe Bolstein et al., Respondents, 125 Misc. 2d 45; 477 N.Y.S. 2d 1014 (1984).

[32] *Id.* at p. 55, 1021.

[33] In the Matter of Topper, 107 Misc. 2d 25; 433 N.Y.S. 2d 359 (1980).

[34] In the Matter of Fred Gunzberg et al., Respondents, v. Art-Lloyd Metal Products Corp., Appellant, 112 A.D. 2d 423, 424; 492 N.Y.S. 2d 83, 85 (1985).

[35] *Id.* at p. 424, 85, citing Kemp v. Beatley, 64 N.Y. 2d 63, 74. *See* In the Matter of Robert H. Burack 137 A.D. 2d 523, 524 N.Y.S. 2d 457 (1988), at p. 527, 460.

[36] In the Matter of Topper, 107 Misc. 2d 25; 433 N.Y.S. 2d 359 (1980); In the Matter of Kemp v. Beatley, 64 N.Y. 2d 63; 473 N.E. 2d 1173; 484 N.Y.S. 2d 799 (1984); In the Matter of Robert H. Burack, 137 A.D. 2d 523; 524 N.Y.S. 2d 457 (1988); In the Matter of Gunzberg, 112 A.D. 2d 423; 492 N.Y.S. 2d 83 (1985).

[37] Matter of Kupersmith (Caduceus Medical Publishers, Inc.), Supreme Court Putnam County, NYLJ, Aug. 22, 1991, p. 21.

[38] *See* Lyons, supra.

[39] *See* O'Neal, 33 The Business Lawyer, at p. 488.

[40] *See* Gene Barry, supra., at p. 559, 541.

[41] *See* O'Donnel, supra, at p. 1207.

FRONT PAY: AN INAPPROPRIATE REMEDY FOR AGE DISCRIMINATION

by

John McGee*

Successful plaintiffs under the Age Discrimination in Employment Act of 1976 (hereafter referred to as the ADEA)[1] may recover lost pay from the date of termination until trial (back pay) plus the pay they would have received from the date of trial until retirement age (front pay). While courts can easily calculate back pay, including fringe benefits and interest, it has proven far more difficult to accurately calculate front pay. A typical description of front pay as "a lump sum representing the discounted present value of the difference between the earnings an employee would have received in his old employment and the earnings he can be expected to receive in his present and future, and by hypothesis inferior, employment"[2] requires the court to speculate about the amount an employee would have received in the future until some hypothetical retirement date. The difficulty of calculating front pay with any degree of certainty makes such damages an inappropriate remedy in age discrimination cases.

The concept of front pay does not appear in the ADEA itself. The remedies section simply says that civil actions may be brought "for such legal or equitable relief as will effectuate the purposes of this chapter," and "legal and equitable relief ... includes ... without limitation judgments compelling employment, reinstatement or promotion".[3] Thus, Congress has given the courts broad authority to fashion remedies and front pay is the innovative remedial scheme that has emerged. Front pay was first proposed in law review articles which suggested that the usual remedies were insufficient to make whole certain workers who had been victims of discrimination. One author even argued that when reinstatement is not appropriate, the *only* way to make a plaintiff whole is with a front pay award.[4]

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