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O'Neal and Derwin: Expulsion or Oppression of Business Associates: "Squeeze-Outs" in Small Enterprises

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Expulsion or Oppression of Business Associates: "Squeeze-Outs" in Small Enterprises. By F. Hodge O'Neal[1] and Jordan Derwin.[2] Durham, N.C.: Duke University Press, 1961, pp. xii, 263. $10.00.

Any study bearing the by-line, F. Hodge O'Neal, on the special problems of the close corporation, is presumptively worthy of attention. No one has written as extensively and intensively on this subject as has he. In 1958, his earlier contributions were collated and amplified in his two-volume work, *Close Corporations: Law and Practice*,[3] the only published treatise on the subject.

The focus of this study, sponsored by a grant from the Federal Small Business Administration Management Research Grant Program, is on "squeeze-outs"[4] in close corporations, although some consideration is given to squeeze-outs in partnerships. The approach is both pragmatic—based on several hundred reported cases and the experiences of many small businessmen, their lawyers and other business advisers—and academic—posing possibilities of potential squeeze-out techniques and their prevention in the light of existing statutory and decisional law. In an appendix are detailed four case histories.[5]

Various squeeze-out settings are comprehensively but not exhaustively discussed with a view to determining the underlying causes of squeeze-outs.

The major discussion is on the various squeeze-out techniques, *e.g.*, withholding dividends; elimination of minority shareholders from the board of directors and from employment; high executive compensation to majority shareholders; extraordinary corporate matters; bankruptcy; issuance of additional shares; and contractual arrangements. Many of these techniques are well known to students of business enterprise law; some of the possibilities are ingeniously devious, such as incorporating a partnership to attain the far greater, varied, and more sophisticated squeeze-out potential avail-

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[3] See Book Reviews, 45 A.B.A.J. 1189 (1959); 1 B.C. Ind. & Com. L. Rev. 335 (1960); 33 Conn. B.J. 321 (1959); 21 Ga. B.J. 225 (1958); 72 Harv. L. Rev. 1187 (1959); 9 J. Pub. L. 245 (1960); 19 La. L. Rev. 233 (1958); 31 Miss. L.J. 195 (1960); 34 N.Y.U. L. Rev. 799 (1959); 26 Tenn. L. Rev. 448 (1959); 26 U.Chi. L. Rev. 347 (1959); 12 Vand. L. Rev. 306 (1958); 5 Wayne L. Rev. 278 (1959). On the basis of his treatment of close corporations in the legal periodicals alone, Professor George D. Hornstein of New York University School of Law is Professor O'Neal's peer.

[4] "Squeeze-out" is used as a synonym for "freeze-out," meaning "the use by some of the owners or participants in a business enterprise of strategic position, inside information, or powers of control, or the utilization of some legal device or technique, to eliminate from the enterprise one or more of its owners or participants" (p. 3)—the aggressors being called "squeezers" and the victims being called "squeezees." Professor O'Neal in his 1958 work uses the term, "freeze-out."

[5] Johnson v. Mansfield Hardwood Lumber Co., 159 F. Supp. 104 (W.D. La. 1958), aff'd, 263 F.2d 748 (5th Cir. 1959), rehearing denied, 268 F.2d 317 (5th Cir. 1959), cert. denied, 361 U.S. 885 (1959); Brown v. Dolese, 154 A.2d 233 (Del. Ch. 1959), aff'd sub nom., Dolese Bros. Co. v. Brown, 157 A.2d 784 (Del. Sup. Ct. 1960); Gaines v. Long Mfg. Co., 234 N.C. 331, 67 S.E.2d 355 (1951), 234 N.C. 340, 67 S.E.2d 350 (1951); Matteson v. Ziebarth, 40 Wash. 2d 286, 242 P.2d 1025 (1952).

able in the corporate form, or, if the local law does not provide a favorable squeeze-out climate for a corporation, merging or consolidating into a corporation incorporated in a more accommodating jurisdiction. Manipulation of share transfer restrictions and the squeeze-out possibilities in tax-option corporations under Subchapter S are also among the subjects covered.

But the approach is not entirely Machiavellian. Arrangements to avoid squeeze-out under present law are outlined in a functional manner, although warranted caution as to the judicial enforceability of some of them in various jurisdictions is expressed. Such counters to squeeze-outs include advance buy-out arrangements; arrangements for settling disputes; shareholder agreements; long-term employment contracts; and intracorporate provisions requiring greater-than-normal votes for shareholder and board of directors action. Sensible use of these arrangements, unfortunately, is best left to legal specialists, who rarely are retained when they should be, namely, when the business enterprise is formed.

Most constructive are the authors' "Idea Guides for Changes in Legal Controls" in the final chapter. Among those suggested are greater judicial discrimination in applying the ostrich-like-approach "business judgment" rule; mandatory dividend statutes; the so-called "fairness" test for extraordinary corporate matters—with the burden of proof on the proponents of the change; broadening of the appraisal remedy to apply to any corporate action which substantially impairs the minority shareholder's position; more imaginative equitable relief; and greater judicial tolerance toward the special problems of the close corporation, especially their intracorporate provisions. The British experiences of using the Board of Trade as a "watchdog" over companies and under Section 210 of the English Companies Act of 1948 are summarized and found to be less than satisfactory solutions.

Susceptible squeezers and squeezees, and their advisors, need this reference work, much as a physician needs a manual on poisons and their antidotes. One might well surmise that the publication of this study will discourage carrying on a small business in the corporate or partnership form and increase the number of individual proprietorships. The legal practitioner, especially of older vintage, can review in this study the tremendous recent growth of the law in this area; the law student will find concise, well-written abstracts of the leading cases, although the $10.00 price of the 263-page book—unfortunate for a study sponsored by the federal government and published by a university press—militates against student purchase.

Greater stress in the two concluding chapters, in the opinion of this reviewer, might have been placed on the need for statutory revision, and less on intracorporate arrangements and judicial enlightenment—important as both are. To the list of "idea guides" (limited, of course, to close corporations), this reviewer would add three that he feels are more significant than those emphasized: (1) liberalization of "statutory norms;"[6] (2) possibility

[6] By "statutory norms" is meant the courts' construction of explicit statutory language and the public policy they glean therefrom—generally to the effect that share-

of eliminating the board of directors;[7] and (3) subjecting associates to fiduciary duties among themselves.[8] These, coupled with the study's suggestion for broadening the appraisal remedy[9]—a remedy far more meaningful in a close corporation than in a corporation whose shares have a stock exchange or over-the-counter market—while no panacea, would deter squeeze-outs by eliminating various technicalities[10] and generally promoting higher business ethics and sounder equitable relief.[11]

Professor O'Neal and Mr. Derwin are to be complimented on this most worthwhile, pioneering study, the first comprehensive one on the subject. It presages well for the future studies in the series of investigations Duke University is making of the legal problems of small business under the sponsorship of the Federal Small Business Administration.

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holders, usually by majority vote of the shares, elect the board of directors which, usually by majority vote per capita, manage the business. This idea is discussed but should have been given more emphasis (see § 8.10). See, e.g., Henn on Corporations and Other Business Enterprises § 259 (1961). See N.C. Gen. Stat. §§ 55-24(a), 55-125 (a)(3) (1960), discussed in O'Neal, Recent Legislation Affecting Close Corporations, 23 Law & Contemp. Prob. 341 (1958); Latty, The Close Corporation and the North Carolina Business Corporation Act, 34 N.C.L. Rev. 432 (1956); N.Y. Bus. Corp. Law (effective April 1, 1963), discussed in Stevens, New York Business Corporation Law of 1961, 47 Cornell L.Q. 141 (1962).

[7] Kessler, The Statutory Requirement of a Board of Directors: A Corporate Anachronism, 27 U. Chi. L. Rev. 696 (1960). But is, as stated in Kaplan v. Block, 183 Va. 327, 335, 31 S.E.2d 893, 896 (1944), a business corporation without a board of directors "an impossible concept"? See Del. Code Ann. tit. 8, § 141 (Supp. 1961); N.Y. Bus. Corp. Law §§ 620(b), 701, 707.

[8] If the shareholders functioned as mutual agents, the fiduciary relationship would inhere as a logical consequence. Cf. N.Y. Bus. Corp. Law § 620(e) (shareholders' duties same as that imposed on directors—presumably to corporation—§ 717—see note 10 infra). Cf. Helms v. Duckworth, 249 F.2d 482 (D.C. Cir. 1957).

[9] Obviously, the appraisal remedy tends to assure that the squeezee receives the fair value of his shares, but presumably the squeezee does not want to be squeezed out. If he elects appraisal, he elects to be squeezed out in most jurisdictions. Furthermore, the very existence of the appraisal remedy might make it his exclusive remedy or result in the denial of equitable relief on the ground that the legal appraisal remedy is adequate. For comparisons of American appraisal statutes, see 2 Model Business Corporation Act Annotated § 74 (1960).

[10] E.g., elimination or at least limitation of "business judgment" rule; imposition of burden of proof on fiduciary where self-interest involved; greater enforceability of intracorporate arrangements; enforcement by individual action (subject to possibility of court's barring actions between "partners"), rather than by derivative action subject to various restrictions on latter.

[11] When all is said and done, the chief anti-squeeze deterrent is uncompromising judicial insistence upon the fiduciary relationship of those in control whether directors, officers, or shareholders, not only to the corporation but also to other shareholders.