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Protecting Minority Shareholders in Close Corporations: Modeling Czech Investor Protections on German and United States Law

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PROTECTING MINORITY SHAREHOLDERS IN CLOSE CORPORATIONS: MODELING CZECH INVESTOR PROTECTIONS ON GERMAN AND UNITED STATES LAW

Abstract: Privatization in the Czech Republic has opened the door to foreign investment. Investors, however, have been slow to invest in the Czech Republic because of its relatively weak shareholder protections. This Note analyzes the shareholder protections in the Czech Republic and suggests changes to the Czech Commercial Code based on German and United States protections for minority shareholders. Implementation of broader shareholder protections will perhaps increase confidence in the Czech Republic and stimulate foreign investment.

INTRODUCTION

Investors face different legal protections depending on the state in which they make an investment. As each decision to invest requires a careful assessment of the risks involved, the protections afforded to investors—one way in which risk may be minimized—may influence where an investor chooses to invest. With increases in global investing and increases in the demand for investment in emerging econo-

1 By “states,” I refer not to the 50 political entities that comprise the United States, but rather the political entities that are equivalent to “nations” or “countries.” See COVEY T. OLIVER ET AL., THE INTERNATIONAL LEGAL SYSTEM 82 (4th ed. 1995).

2 See infra notes 77–86, 101–05, 141, 171–72, 179 and accompanying text (discussing minority shareholder protections in the Czech Republic, Germany, and the United States).


mies,5 the differences among state investor protections may play a
greater role in the analysis of investment risks.6

The recent privatizations in many of the former communist states
of East and Central Europe provide opportunities to examine the de­
velopment of investor protections and the effect such protections
have on investor decisions.7 Emerging economies often look to their
Western counterparts for investment and guidance.8 At the same time,
Western investors are increasingly looking to emerging economies for
investment opportunities.9 By examining investor protections in both
emerging economies and developed economies, comparing those
protections, and assessing their relative strengths and weaknesses, one
may determine how emerging economies can create investment in­
centives by adopting stronger investment protections.10

Minority shareholders in close corporations,11 a subset of the
numerous categories of investors, have received protections based on
duties owed by other shareholders.12 These investors—owning only a

5 See Kissane, supra note 4, at 621; Philbrick, supra note 3, at 565–67; Speeckaert, supra
note 4, at 39. “Emerging economies,” as used in this article, refers to those states that have
recently been making the transition from planned economies to market economies. See
Bernard Black & Reinier Kraakman, A Self-Enforcing Model of Corporate Law, 109 HARV. L.
6 See Kissane, supra note 4, at 621; Philbrick, supra note 3, at 590.
7 See infra notes 44–64, 77–86 and accompanying text (discussing privatizations in the
Czech Republic and the development of investor protections).
699, 706 (1997); Kissane, supra note 4, at 674; Philbrick, supra note 3, at 593; Sergio Salani
& Jerry Sloan, An Overview of Legal and Financing Aspects for Doing Business in Hungary, Po­
land, and the Czech Republic, 9 TEMP. INT’L & COMP. L.J. 27, 28–29, 53 (1995); Speeckaert,
supra note 4, at 38. For example, in 1992, Kmart purchased several department stores in the
Czech Republic (at that time part of Czechoslovakia). See Robert C. Toth, Kmart Buys Up a
Dozen Department Stores in Czechoslovakia, L.A. TIMES, May 8, 1992, at 12. In addition to
purchasing the stores, Kmart planned to introduce retailing, technology, and distribution
know-how to the Czech Republic. See id.
9 See Jordaan, supra note 4, at 134.
10 See infra notes 324–38 and accompanying text (discussing suggestions for improving
investor protections in the Czech Republic based on German and U.S. protections).
11 For a definition of a close corporation, see infra note 134 and accompanying text.
12 See infra notes 77–86, 101–05, 141, 171–72, 179 and accompanying text (outlining
minority shareholder protections in the close corporation context). It is important to note
that while investors may derive protection from duties owed by corporate directors, direc­
tors in a close corporation, in many cases, are also shareholders. See, e.g., Donahue v. Rodd
Electrotype, 328 N.E.2d 505, 511 (Mass. 1975). A full discussion of director duties, how­
ever, falls beyond the scope of this Note. The protections based on duties owed by other
shareholders shall be referred to generally as “minority shareholder protections” for the
remainder of this Note.
small, illiquid interest in a business entity—generally do not have the ability to control business decisions. As this lack of control creates additional investment risks, minority shareholders are systematically more vulnerable than other investors. This systematic disadvantage has prompted several states to adopt specific protections for minority shareholders.

The Czech Republic, one of the biggest success stories in Eastern Europe, currently seeks to reestablish itself as a highly developed state. To accomplish this goal, the Czech Republic has taken several steps to make its business atmosphere more inviting to the Western business community. Although the Czech Republic has a skilled, inexpensive workforce, a strong industrial base, an excellent infrastructure, a democratic tradition, and proximity to both Eastern and Western markets, the Czech Republic still lacks the high degree of foreign investment found in Poland and Hungary. In order to

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16 See infra notes 77-86, 101-05, 141, 171-72, 179 and accompanying text (discussing how the Czech Republic, Germany, and the United States have responded to minority shareholder concerns).
17 See Bejcek, supra note 8, at 707; Richard Pivnicka & Mark Kreisl, *Czech Republic: Investment in Freedom and the Future,* 1 INT’L DIMENSIONS 6, 8 (1997).
18 See Pivnicka & Kreisl, supra note 17, at 6. Prior to World War II, the Czech Republic (then part of Czechoslovakia) was the sixth wealthiest and one of the ten largest industrialized countries in the world. See Bejcek, supra note 8, at 699; Frederick Kempe & Cacilie Rohwedder, *Top Executives Name Czech Republic Most Attractive for Future Investments,* WALL ST. J., July 9, 1993, at A6.
19 See Salani & Sloan, supra note 8, at 28-29, 53.
20 See Henry W. Lavine et al., *Czech and Slovak Privatization: Issues and Approaches for Western Investors,* in *JOINT VENTURES AND OTHER FINANCING TECHNIQUES IN POLAND, HUNGARY, CZECHOSLOVAKIA, AND ROMANIA* 61, 66 (1992); Pivnicka & Kreisl, supra note 17, at 6; Salani & Sloan, supra note 8, at 29; Kempe & Rohwedder, supra note 18, at A6.
21 See id.
22 See Salani & Sloan, supra note 8, at 29.
23 See Pivnicka & Kreisl, supra note 17, at 6; Kempe & Rohwedder, supra note 18, at A6.
24 See Lavine et al., supra note 20, at 67; Pivnicka & Kreisl, supra note 17, at 6; Kempe & Rohwedder, supra note 18, at A6.
stabilize its stock market and continue developing its free market economy, the Czech Republic needs to rely on foreign participation.\textsuperscript{26}

This Note examines the comparative protections for minority shareholders in close corporations as promulgated by the Czech Republic, Germany, and the United States in order to understand how the Czech Republic may better protect minority shareholders and attract foreign investors. Although a full discussion of the usefulness of a comparison of Czech law to German and U.S. law follows in Part IV, it is important to note initially that the Czech Republic has already looked to Germany and the United States as models for some of its own laws, and any changes in Czech investment laws will affect Germany and the United States to some extent because the bulk of foreign investment comes from Germany and the United States. Part I discusses the transition to a market economy in the Czech Republic, forms of legal business entities in the Czech Republic, and statutory protections for minority shareholders recently enacted by the Czech Republic. This Part also discusses the structure of close corporations and minority shareholder protections in both Germany and the United States. Part II presents the investment issues unique to minority shareholders in close corporations. Part III undertakes a comparative analysis of the minority shareholder protections in the three states examined. Part IV suggests that in order to improve minority shareholder protections in the Czech Republic, the Czech Republic should adopt an amendment to the Commercial Code that will provide greater access to buyout remedies. This Note concludes that by emulating German and U.S. minority shareholder protections, the Czech Republic can develop a system of protection that is more enticing to foreign investors, maintain economic stability, and foster market growth.

\textsuperscript{26} See Philbrick, \textit{supra} note 3, at 593. Due to the insufficiency of domestic savings, Eastern European stock markets need to look to foreign sources of investment in order to maintain adequate capitalization. \textit{See id.}
I. BACKGROUND

A. Czech Republic

1. History of Czech Commercial Practice

The Austrian Commercial Code of 1863 governed business practice in Czechoslovakia until World War II. Czechoslovakia flourished during the time before World War II, ranking as one of the world’s most developed economies. The communists, following their takeover of Czechoslovakia in 1948, replaced the Austrian Commercial Code of 1863 with a nationalization scheme that eviscerated private enterprise. Under the communist regime, the Civil Code, the Economic Code, and the Code of International Trade, were developed.

On December 29, 1989, the collapse of communism in Czechoslovakia ushered in an era fraught with economic, social, and political change. Following this collapse, Czechoslovakia faced the difficult task of determining how it would approach its goal of economic and political liberalization. The mere shift in political power and the introduction of a market economy were insufficient. In order to complete this transformation, Czechoslovak law had to restore private property rights, privatize state-owned businesses, and both stabilize and reduce inflation. Communist law severely limited the accomplishment of these goals.

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28 See Bejcek, supra note 8, at 702.
30 See Bejcek, supra note 8, at 702; The New Bohemians, supra note 29, at 23.
31 See Bejcek, supra note 8, at 701. The Civil Code regulated relations between citizens and “socialist organizations”; the Economic Code set forth the laws for the management and governance of these “socialist organizations”; and the Code of International Trade governed relations with foreign business partners. See id. at 702, 705. The government determined whether an organization qualified as a "socialist organization" in rather ideological and arbitrary manners. See id. at 702.
32 See Pivnicka & Kreisl, supra note 17, at 6.
34 See Bejcek, supra note 8, at 706.
36 See Bejcek, supra note 8, at 707.
On January 1, 1992, the Commercial Code replaced the three codes promulgated by the communist regime. The Commercial Code was passed in order to stabilize the economy, facilitate business, and encourage investment in the emerging economy. The Commercial Code governs all organized business activities except for activities of state enterprises. The Commercial Code, according to its text, was also designed to harmonize Czechoslovak law with the law of other European countries.

The Czechs and Slovaks could not agree, inter alia, on the pace of liberalization, and the two entities peacefully split on January 1, 1993. Upon the split of Czechoslovakia into the Czech Republic and Slovakia, all federal laws continued to be in effect for each state. Therefore, the Commercial Code, although enacted while the Czech Republic was part of Czechoslovakia, remained law in the Czech Republic.

2. Privatization

Throughout Central and Eastern Europe, the trend for former communist states has been to develop privatization schemes. Privatization is the transferal of ownership of state-owned enterprises to private parties. The goal of privatization is to promote economic efficiency by removing state controls and allowing more competitive producers to respond to market demands.

The Czech Republic, pursuing a faster pace of economic liberalization than its Slovak counterpart, has sought rapid privatization of its state-owned enterprises. The Czech Republic’s privatization plan has

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37 See Salani & Sloan, supra note 8, at 45. The Commercial Code was codified in Act No. 513/1991 Sbírka zákon (Collection of Laws), cited in Bejcek, supra note 8, at 700 n.3.
39 See Carroll, supra note 27, at 28.
40 See Andrus, supra note 38, at 620.
41 See Carroll, supra note 27, at 26; Fiala & Hruska, supra note 35, at 296.
42 See Carroll, supra note 27, at 27; Fiala & Hruska, supra note 35, at 296.
43 See Andrus, supra note 38, at 620–21; Bejcek, supra note 8, at 700; Fiala & Hruska, supra note 35, at 296.
45 See Carroll, supra note 27, at 29; Philbrick, supra note 3, at 577.
47 See Carroll, supra note 27, at 26.
served as a model for other East and Central European countries seeking to establish market economies.48

The Czech Republic accomplished its privatization goals through two different privatization laws.49 First, the Small Privatization Law was designed to facilitate the transfer of small state-run business to private owners.50 These businesses were sold through public auctions.51 The privatization of over 10,000 small businesses52 was completed in 1993.53 Second, the Large Privatization Law facilitated the transfer of large enterprises to private owners.54 In order to qualify under the Large Privatization Law, businesses had to submit privatization plans to the Ministry of Finance for approval.55 Although large businesses could be privatized through a direct sale,56 privatization for most large businesses was effectuated by the coupon privatization process.57

In May 1992, the Czech Republic (at that time still a part of Czechoslovakia58), initiated the world’s first mass privatization plan59 when it transferred about US$10 billion of property to the public through a coupon privatization scheme.60 The second round of coupon privatization, beginning on October 1, 1993,61 resulted in an ag-
Aggregate transfer of 80% of the state’s assets to the public.62 According to Tomás Jezek, Chairman of the Czech Stock Exchange Chamber, the total privatization by 1997 amounted to 90% of formerly state-owned assets, with 60% of Czech citizens63 participating in the privatization.64

3. Structure of Legal Business Entities

The four legal business entities established by the Commercial Code are the limited liability company *(spolecnost s rucením omezeným)*, joint stock company *(akciová spolecnost)*, general partnership *(verejná obchodní spolecnost)*, and limited partnership *(komanditní spolecnost na akcie)*.65 The limited liability company and the joint stock company are the two most common business entities.66

In a limited liability company, a shareholder is only liable for any unpaid capital.67 Each shareholder must invest at least 20,000 Czech crowns (Kč),68 and the number of shareholders is limited to fifty.69 The minimum capitalization requirement for a limited liability company is 100,000 Kč.70 A shareholder in a limited liability company may not withdraw from the company, but the shareholder may be expelled by the other shareholders.71 Limited liability companies have a flexible management structure—management may be effectuated however the shareholders determine.72

For a joint stock company, the major requirement is a net capitalization of one million Kč.73 A shareholder is not personally liable for any of the company’s obligations.74 Joint stock companies must have a supervisory board.75 Shareholders may pass resolutions with a

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62 See Holman, supra note 48, at A14.
63 See Medicine, supra note 25. According to another estimate, however, approximately 80% of Czech citizens purchased shares. See Bejcek, supra note 8, at 707 n.36.
64 See Medicine, supra note 25.
65 See Salani & Sloan, supra note 8, at 45.
66 See Fiala & Hruska, supra note 35, at 297.
67 See Pivnicka & Kreisl, supra note 17, at 6; Salani & Sloan, supra note 8, at 45.
69 See Fiala & Hruska, supra note 35, at 297.
70 See id.
71 See Andrus, supra note 38, at 623 & n.100.
72 See Salani & Sloan, supra note 8, at 45.
73 See Pivnicka & Kreisl, supra note 35, at 297; Pivnicka & Kreisl, supra note 17, at 7.
74 See Pivnicka & Kreisl, supra note 17, at 7.
75 See Salani & Sloan, supra note 8, at 45.
simple majority vote if a quorum of 30% of the shareholders are present.76

4. Minority Shareholder Protections

In 1996, the Czech government introduced amendments to the Commercial Code that were designed to provide minority shareholder protections.77 These amendments were also intended to afford protections similar to other European countries.78 Effective July 1, 1996, these amendments introduced strict buyout rules in takeovers.79 At any time a takeover occurs, the person effectuating the takeover must offer to purchase the shares of the remaining shareholders for the average market price of those shares.80 This buyout remedy now affords minority shareholders an opportunity to exit the corporation.81 Furthermore, the amendments create limitations on minority shareholder squeeze-outs.82 Prior to the amendments, minority

76 See Andrus, supra note 38, at 625.
77 See Act No. 142/1996 Sbírka zákon (Collection of Laws) Amending the Commercial Code and the Civil Code, cited in Coogan et al., supra note 44, at 499; Legislative Changes Will Bring Greater Transparency and Shareholder Protection to Czech Capital Market, E./W. EXECUTIVE GUIDE, July 1, 1996 [hereinafter Legislative Changes]. Foreign investors are equally protected by the amendment because the Commercial Code provides that all foreign investors may conduct business under the same conditions as Czech investors. See Fiala & Hruska, supra note 35, at 297.
78 See Medicine, supra note 25. These amendments were modeled on both European Union guidelines and German law. See Susan Tietjen, Recent Amendments to the Czech Commercial Code and Securities Act, CENT. EUR. L. COMMITTEE NEWSL. (Am. Bar Ass'n Section of Int'l Law and Practice, Washington, D.C.), Summer 1996, at 2. It is important that the Czech Republic model its protections on those of other European states because it currently seeks admission into the European Union. Significantly, the European Union has proposed the adoption of stronger minority shareholder protections as a short-term objective for accession. See Accession Partnership-Czech Republic-October 1999-Draft (visited Dec. 8, 1999) <http://europa.eu.int/comm/enlargement/docs/index.htm> [hereinafter Accession Partnership]. For more specific examples of these similarities, compare infra notes 79–86 and accompanying text with Miller, supra note 13, at 393, 396, 403 (discussing buyout remedies in Germany and the United Kingdom).
79 See Coogan et al., supra note 44, at 499; Legislative Changes, supra note 77. Any acquisition by a person of more than one-half, two-thirds, or three-fourths of the aggregate nominal value of a company's voting shares constitutes a takeover. See Tietjen, supra note 78, at 3.
80 See Legislative Changes, supra note 77. The average market price for the purpose of the shareholder buyout is calculated according to the price of the stock over the previous six months. See id. Furthermore, in order to prevent circumvention of the strict buyout requirement, the amendment considers a "shareholder" to include any group acting in accord. See id.
81 See Tietjen, supra note 78, at 3.
82 See Coogan et al., supra note 44, at 499; Tietjen, supra note 78, at 4. For a discussion of squeeze-outs, see infra notes 231–35 and accompanying text.
shareholders were subject to squeeze-outs when corporations canceled the ability to publicly trade shares or imposed restrictions on the transfer of shares. Due to this imposed lack of liquidity, minority shareholders were pressured to sell their shares on majority shareholders’ terms. The amendments now require shareholder votes to either cancel the public tradability of shares or to impose limitations on the transferability of shares. If the corporation obtains shareholder approval for either of these changes, it must offer to purchase the shares of all shareholders who did not vote for the change.

B. Germany

1. Structure of Close Corporations—the GmbH

The limited liability company (Gesellschaft mit beschränkter Haftung or GmbH) is the German form of business that meets the characteristics of a close corporation. The GmbH is the most common business entity and is governed by the Gesetz betreffend die Gesellschaften mit beschränkter Haftung (GmbH Law). The minimum capitalization requirement for a GmbH is 50,000 German Marks (DM). Each shareholder in a GmbH must contribute at least 500 DM.

The GmbH has a flexible management structure. The GmbH need not create a supervisory board, and shareholders maintain ultimate authority over business matters. The shares of a GmbH are

83 See Tietjen, supra note 78, at 4.
84 See id.
85 See id. A majority vote of the shareholders (where each shareholder has one vote regardless of how many shares he or she holds) and a three-fourths vote of those shareholders who will be affected by the change are required in order to cancel the public tradability of shares. See id. To limit the transferability of shares, a corporation must obtain a two-thirds vote of the shareholders and a three-fourths vote of those shareholders who will be affected by the change. See id.
86 See Tietjen, supra note 78, at 5.
87 See Miller, supra note 13, at 394.
88 See id. at 384, 395.
90 See id. at 134.
91 See Miller, supra note 13, at 395. As of Thursday, April 1, 1999, one United States dollar was equivalent to 1.8126 DM. See Currency Trading—Exchange Rates, supra note 68, at C11.
92 See Miller, supra note 13, at 395.
93 See id. at 394.
94 See id. at 394–95.
relatively illiquid. Shares of a GmbH—referred to in German as "business interests" (Geschäftsanteile)—may not be traded on the stock exchange. Transfer of shares must be effectuated by a notarial act. As a result of this close-corporate structure, minority shareholders in a GmbH may be vulnerable to abuse by dominant shareholders.

2. Minority Shareholder Protections

Although Germany is a civil law country, both statutory and judicial remedies protect minority shareholders in a GmbH. These remedies provide minority shareholders with a means to regulate the conduct of majority shareholders. Similar to traditional remedies in the United States, the German judiciary has been granted statutory authority to dissolve a GmbH. The grounds for dissolution in Germany, however, are when a court concludes that a company can no longer accomplish its purposes or when it concludes that there are substantial causes (wichtige Grund) for dissolution. Two major downsides of dissolution, however, are the loss of the business and the loss of jobs.

Beyond this statutory authority, the judiciary has developed two other highly discretionary remedies: withdrawal (Austritt) and expulsion (Ausschließung). Both of these remedies require the showing of

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95 See Scogin, Jr., supra note 89, at 133 n.20.
97 See Scogin, Jr., supra note 89, at 133 n.20.
98 See Miller, supra note 13, at 382. The vulnerability of the minority shareholders in a GmbH mirrors the vulnerability of minority shareholders in a U.S. close corporation. See infra notes 139–40, 217–21 and accompanying text.
99 See Miller, supra note 13, at 392, 396.
100 See id. at 396.
101 See Scogin, Jr., supra note 89, at 134.
102 See Miller, supra note 13, at 396. The Gesetz betreffend die Gesellschaften mit beschränkter Haftung (GmbH Law) grants the judiciary this authority in § 61(1). See id. at 396 n.78; Scogin, Jr., supra note 89, at 134–35. Section 61 of the GmbH Law provides that: "[t]he company may be dissolved by a court decision in case it becomes impossible to accomplish the purpose of the company or when there are other substantial causes (wichtige Grund) for the dissolution resulting from the conditions of the company." Scogin, Jr., supra note 89, at 134.
103 See id.
104 See id. at 135.
a wichtige Grund. Neither of these remedies may be waived or restricted by the articles of incorporation.

Wichtige Grund in a withdrawal proceeding may be established through any of the following categories: personal characteristics of the departing shareholder, behavior of other shareholders, or the existence of special factors. Significantly, neither fault nor exclusion from decision making are necessary to establish wichtige Grund, thereby making wichtige Grund broader than U.S. notions of fiduciary duties. The underlying premise for granting a right of withdrawal is that an individual should not be forced to stay in a long term relationship when the circumstances have “permanently and negatively changed.” Therefore, the breadth of wichtige Grund indicates that the withdrawal remedy will be widely available to minority shareholders.

In order to effectuate withdrawal, the shareholder who wishes to depart must first give notice to the company. Next, the shareholder must obtain consent from the remaining shareholders. If the shareholder who wishes to withdraw does not receive consent from the remaining shareholders, the aggrieved shareholder may bring a court action seeking a withdrawal order. If a shareholder obtains a withdrawal right, either through consent or judicial order, that shareholder may leave the company and obtain the fair market value of his or her shares.

105 See Miller, supra note 13, at 396.
106 See Scogin, Jr., supra note 89, at 135.
107 See Miller, supra note 13, at 397; Scogin, Jr., supra note 89, at 154–55. Scogin elaborates on these three theories for withdrawal by providing concrete examples. See Scogin, Jr., supra note 89, at 155. Personal characteristics of the departing shareholder may include financial need, illness, relocation, and an inability to fulfill the shareholder role. See id. Behavior of other shareholders may encompass the arbitrary exercise of majority power or the continuation of a dispute among shareholders. See id. Finally, special factors may include a lack of long-term returns on a shareholder’s investment or a change in the purpose of the company. See id.
108 See id. at 155. United States fiduciary duties, in contrast to the personal characteristics that may constitute wichtige Grund, include such elements as disloyalty, self-dealing, oppression, and bad faith. See Scogin, Jr., supra note 89, at 135.
109 See id.
110 Id. at 155.
111 See id. at 154. In fact, the withdrawal remedy is available to all shareholders. See id.
112 See Scogin, Jr., supra note 89, at 156.
113 See id.
114 See Miller, supra note 13, at 396.
115 See id.
A shareholder’s ability to withdraw from a company and obtain value for his or her interest in the company overcomes the illiquidity problem that faces minority shareholders in close corporations. On the other hand, a shareholder who withdraws still faces the loss of involvement with the company and the loss of future earnings. In these respects, withdrawal rights closely resemble U.S. buyout remedies.

The expulsion remedy permits an aggrieved shareholder to remove the problem (i.e., the shareholder sought to be expelled) without losing his or her stake in the company. The ability to remove the problem without removing one’s self from participation in the corporation presents a marked contrast to withdrawal. Expulsion, because it is unavailable in the United States, presents the largest contrast to U.S. remedies. If expulsion is granted, the expelled shareholder will be required to leave the company after being paid the fair market value of his or her interest in the GmbH. The underlying premise for granting expulsion is that a majority position should not be carte blanche for a majority shareholder to do whatever he or she wants.

Wichtige Grund in an expulsion action is narrower than in a withdrawal action. The grounds for proving wichtige Grund in an expulsion action involve only the personal characteristics of the shareholder in question and the conduct of that shareholder. For

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116 See Scogin, Jr., supra note 89, at 135.
117 See id.
118 See infra notes 257-58 and accompanying text.
119 See Scogin, Jr., supra note 89, at 156. Expulsion, because it is available to any shareholder who establishes wichtige Grund, may, however, be used against a minority shareholder. See Miller, supra note 13, at 399 (discussing how German remedies contrast with U.S. remedies because U.S. remedies are primarily geared toward minority shareholders).
120 See supra note 117 and accompanying text.
121 See Miller, supra note 13, at 399; Scogin, Jr., supra note 89, at 136.
122 See Miller, supra note 13, at 396; Scogin, Jr., supra note 89, at 158.
123 See Scogin, Jr., supra note 89, at 158.
124 See id. at 160. The European Union has taken notice of the Czech capital markets system, as it has emphasized minority shareholder protections and the Securities and Exchange Commission in its most recent proposed Accession Partnership. See Accession Partnership, supra note 78.
125 See Miller, supra note 13, at 397. But see supra note 107 and accompanying text (discussing wichtige Grund in the withdrawal context). Personal characteristics may include such factors as age, illness, or mental incapacity. See Scogin, Jr., supra note 89, at 160. Shareholder conduct may include such acts as breaching the trust of other shareholders, financial mismanagement, causing conflicts among shareholders, and making improper sexual advances. See id.
example, in a 1953 decision, the German court considered the defendant’s commission of adultery to be a relevant factor in granting expulsion. In that case, the court also considered the defendant’s mismanagement of funds and unauthorized purchases as factors contributing to a finding of wichtige Grund.

The procedure for expelling a shareholder first begins with a vote by the shareholders. The shareholder in question, however, may not vote on the matter. This voting procedure makes it possible for a minority shareholder to vote to expel a majority shareholder. If the requisite majority of the vote is achieved, the court must order the expulsion as long as it is satisfied that there is a wichtige Grund. The expelled shareholder then must be paid the value of his or her holding.

C. United States

1. Close Corporations

Close corporations, the most common form of business entity in the United States, generally have a small number of shareholders and no ready market for their shares. In addition, shareholders in close corporations often participate in management. Close corporations—often viewed as intimate relationships—are usually formed

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126 See Entscheidungen des Bundesgerichtshofes in Zivilsachen (Supreme Court) decision of April 1, 1953, BGHZ 9, 157 [hereinafter April 1, 1953 Decision], cited in Miller, supra note 13, at 398 & n.90.

127 See id.

128 See Scogin, Jr., supra note 89, at 157.

129 See id.

130 See id. at 136, 157. In its decision of April 1, 1953, the German court held explicitly that a minority shareholder can expel a majority shareholder if wichtige Grund is established. See April 1, 1953 Decision, cited in Scogin, Jr., supra note 89, at 157 & n.123.

131 See Scogin, Jr., supra note 89, at 157. The general trend is to require a supermajority vote for expulsion. See id. Some commentators, however, argue that only a simple majority should be required. See id.

132 See id. at 158.

133 See Chernichaw, supra note 14, at 501; Miller, supra note 13, at 383.

134 See M. Thomas Arnold, Shareholder Duties Under State Law, 28 TULSA L.J. 213, 240 (1992). In Donahue v. Rodd Electrotype Co., the Supreme Judicial Court of Massachusetts defined a close corporation as having "(1) a small number of stockholders; (2) no ready market for the corporate stock; and (3) substantial majority stockholder participation in the management, direction and operations of the corporation." 328 N.E.2d 505, 511 (Mass. 1975).

135 See Arnold, supra note 134, at 240 n.205; Chernichaw, supra note 14, at 507.

136 See Arnold, supra note 134, at 234; Chernichaw, supra note 14, at 507.
by family members and friends.\footnote{See Arnold, supra note 134, at 234; Miller, supra note 13, at 383.} Approximately 95\% of close corporations are family-owned.\footnote{See Chernichaw, supra note 14, at 501.}

In close corporations, the minority shareholders often become employees and rely on their salaries as their return on investment.\footnote{See Arnold, supra note 134, at 234. A guarantee of employment may be one of the major reasons why a minority shareholder chooses to invest in a close corporation. See Murdock, supra note 15, at 435.} As the majority may control compensation and employment decisions, not only is the minority shareholder vulnerable to losing his or her investment, but the minority shareholder is often at risk of losing his or her job.\footnote{See Murdock, supra note 15, at 435.}

2. Minority Shareholder Protections

a. Dissolution and Its Progeny

The traditional remedy for minority shareholders has been to seek dissolution of the corporation.\footnote{See Scogin, Jr., supra note 89, at 129–30.} Dissolution involves the winding up of corporate affairs, selling the corporation's assets, paying off corporate debt, and distributing the remaining capital to shareholders on a pro rata basis.\footnote{See Chernichaw, supra note 14, at 517–18.} Although viewed as a rather drastic remedy, dissolution is the most common form of relief granted to minority shareholders by state legislatures.\footnote{See id. at 426, 441; Scogin, Jr., supra note 89, at 130.} As is precisely the case in Germany, dissolution in the United States is also drastic because the corporation is extinguished, along with any hope of future profits.\footnote{See Murdock, supra note 15, at 455. For example, the Revised Model Business Corporation Act provides for dissolution upon (i) director deadlock, (ii) oppression, (iii) shareholder deadlock, or (iv) waste. REVISED MODEL BUS. CORP. ACT § 14.30(2), reprinted in CORPORATIONS AND BUSINESS ASSOCIATIONS: STATUTES, RULES, MATERIALS, AND FORMS 480, 660–61 (Melvin Aron Eisenberg ed., 1998) [hereinafter CORPORATIONS AND BUSINESS ASSOCIATIONS].}

Although several grounds for dissolution have been advanced by legislatures, the most common basis for dissolution has been a minority shareholder’s claim of oppression.\footnote{See Murdock, supra note 15, at 435.} Despite adoption of the term
“oppression” by a number of jurisdictions, courts have varied with regard to what conduct they will deem to be oppressive.\textsuperscript{146}

Until the 1980s, Illinois led the United States in developing the contours of oppression.\textsuperscript{147} The 1933 Illinois Business Corporation Act first introduced oppression as a basis for liquidation.\textsuperscript{148} Beginning with \textit{Central Standard Life Ins. Co. v. Davis}, the Supreme Court of Illinois held that oppression did not require a finding of fraud or illegal conduct.\textsuperscript{149} Illinois courts have held that heavy-handed and arbitrary conduct on the part of another shareholder will constitute oppression for the purpose of dissolution.\textsuperscript{150} Some examples of this conduct include exclusion from control and participation in corporate affairs,\textsuperscript{151} misuse of corporate funds or assets,\textsuperscript{152} and failure to pay dividends.\textsuperscript{153} Several jurisdictions have followed the lead of Illinois decisions in recognizing broad bases for oppression.\textsuperscript{154}

After the 1980s, New York led the way in developing the reasonable expectations test in order to determine whether there has been oppressive conduct.\textsuperscript{155} This development in the New York courts fol-

\textsuperscript{146} See Murdock, \textit{supra} note 15, at 426, 455–61. Courts have addressed the issue of oppressive conduct in several cases, with varying results. \textit{See}, e.g., Capitol Toyota, Inc. v. Bervin, 381 So.2d 1038, 1039 (Miss. 1980) (finding no oppression where “reasonable expectations have been thwarted, but not grossly so”); Baker v. Commercial Body Builders, Inc., 507 P.2d 387, 394 (Or. 1973) (finding a close tie between oppression and the fiduciary duty of good faith and fair dealing); White v. Perkins, 189 S.E.2d 315, 320 (Va. 1972) (finding oppression to constitute “a visible departure from the standards of fair dealing”); Gidwitz v. Lanzit Corrugated Box Co., 170 N.E.2d 131, 138 (Ill. 1960) (finding oppression where corporation’s president acted “in an arbitrary and high-handed manner”); Fix v. Fix Material Co., 538 S.W.2d 351, 358 (Mo. Ct. App. 1976) (finding that although oppression is closely tied to fiduciary duties, a single breach of fiduciary duty will not constitute oppression unless extremely serious or causes “irreparable injury, imminent danger of loss or miscarriage of justice”).

\textsuperscript{147} See Murdock, \textit{supra} note 15, at 455.

\textsuperscript{148} See \textit{id.} at 455 & n.199. This Act was the basis for the Revised Model Business Corporation Act. \textit{See id.} at 455.

\textsuperscript{149} See 141 N.E.2d 45, 50 (III. 1957); \textit{see also} Gidwitz, 170 N.E.2d at 138 (where the Supreme Court of Illinois held that “[i]t is not necessary that fraud, illegality or even loss be shown”).


\textsuperscript{151} See Gidwitz, 170 N.E.2d at 135; Compton, 285 N.E.2d at 581.


\textsuperscript{154} \textit{See generally} Murdock, \textit{supra} note 15, at 457–61 (discussing the development of oppression in other United States jurisdictions).

\textsuperscript{155} \textit{See id.} at 454, 465. A New Jersey decision, however, first introduced the standard of reasonable expectations as a means by which a court could find oppression. \textit{See} Exadaktilos
owed 1979 legislation providing a buyout remedy as an alternative to dissolution.156

In re Topper, the first New York case to articulate the reasonable expectations standard, involved a one-third shareholder of two pharmacies who sought either dissolution or a buyout.157 Topper, the minority shareholder seeking judicial relief, put his life savings into the pharmacies, gave up a job in the drug business that he had held for twenty-five years, and moved his family from Florida to New York in order to participate in the business.158 Although Topper’s salary was raised from $30,000 to $75,000 during the time that he was involved with the businesses, Topper was fired after one year and was removed as an officer.159 In finding oppressive conduct, the New York court held that “the respondents’ actions ... severely damaged [Topper’s] reasonable expectations.”160 “These reasonable expectations,” the court continued, “constitute the bargain of the parties in light of which subsequent conduct must be appraised.”161

Under New York law, the “bargain of the parties” does not necessarily mean the agreement (explicit or implied) among the founders of a corporation.162 Therefore, reasonable expectations may encompass expectations generated by subsequent events, shareholders who join the corporation after its foundation, or shareholders who are generations removed from the founders.165


158 Id. at 361–62.

159 Id.

160 Id. at 362. See also In re Taines, 444 N.Y.S.2d 540, 544 (Sup. Ct. 1981) (finding frustration of a shareholder’s reasonable expectations on similar facts).

161 In re Topper, 433 N.Y.S.2d at 365 (finding that these reasonable expectations include participating in management and receiving salary from employment with the business). New York courts have also held that the expectation of fair dealing on the part of other shareholders is a reasonable expectation. See Gimpel v. Bolstein, 477 N.Y.S.2d 1014, 1020 (Sup. Ct. 1984).

162 See generally O’Donnel v. Marine Repair Servs., Inc., 530 F. Supp. 1199 (S.D.N.Y. 1982) (where plaintiff became a shareholder after the corporation was formed); Gimpel, 477 N.Y.S.2d 1014 (where parties were generations removed from the founding of the corporation).

163 See In re Topper, 433 N.Y.S.2d at 365.

164 See O’Donnel, 530 F. Supp. at 1207.

165 See Gimpel, 477 N.Y.S.2d at 1016.
The Court of Appeals of New York in In re Kemp & Beatley, Inc. further clarified the standard for finding oppression by holding that the expectations of an aggrieved shareholder must be both objectively reasonable and central to the decision to enter into the business venture.166 After finding that the corporation awarded de facto dividends to all shareholders except the minority shareholders, thereby preventing the minority shareholders from receiving a return on their investments, the court found that there was oppressive conduct on the part of the majority shareholders.167

The reasonable expectations test for finding oppression has been widely used in a different remedial context—judicially supervised buyouts.168 As dissolution is viewed as a drastic remedy,169 courts and legislatures have created remedies for oppressed minority shareholders that fall short of requiring the extinction of the corporation.170 Examples of alternative remedies generally include judicial action by means of an injunction or order, appointment of provisional directors or custodians, and buyouts.171 Buyouts, however, have been the focus of alternative relief.172

A buyout occurs when a court orders a corporation to purchase a minority shareholder’s interest.173 Although this permits a minority shareholder to overcome the problem of illiquidity, receive some return on his or her investment, and exit the corporation, courts have struggled with how to determine the value of the minority shareholder’s interest.174 Several complications include determining the method for valuation,175 assessing whether to discount the value because it is a minority interest,176 considering whether to discount the

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166 473 N.E.2d 1173, 1179 (N.Y. 1984). See also Chernichaw, supra note 14, at 514.
167 In re Kemp & Beatley, Inc., 473 N.E.2d at 1175–76.
168 See Murdock, supra note 15, at 461.
169 See id. at 426.
171 See Thompson, supra note 170, at 228–32.
173 See Thompson, supra note 170, at 228–29.
174 See Murdock, supra note 15, at 470–71; Thompson, supra note 170, at 232.
175 See Murdock, supra note 15, at 473.
176 See Thompson, supra note 170, at 233.
value because of the lack of a market, and calculating to what extent, if any, an adjustment should be made for the oppressive conduct.

b. Fiduciary Duties of Good Faith and Loyalty

An alternative to granting remedies for minority shareholder oppression has been to award remedies on a theory of fiduciary duties owed to shareholders. Following the leading Massachusetts case, Donahue v. Rodd Electrotype Co., several jurisdictions have fashioned similar standards. Some examples of conduct that have been found to violate fiduciary duties are: selective repurchases by the corporation of its shares, terminating a shareholder/employee's employment, violating share redemption agreements, issuing shares to change the relative control of the shareholders, and causing the corporation to favor a shareholder's company in discharging debt. Although imposing fiduciary duties is a clear trend in U.S. case law, imposing these duties may not necessarily allow a minority shareholder to recover his or her investment and exit the company.

Fiduciary duties—the obligations of good faith and loyalty—derive from the context of partnerships. Close corporations resemble partnerships because the business relationships in both are character-
ized by trust, confidence, and loyalty.\textsuperscript{185} Often, close corporations, much like partnerships, are founded by a few people who contribute not only capital, but also experience and labor.\textsuperscript{186}

\textit{Donahue v. Rodd Electrotype Co.}, a Massachusetts Supreme Judicial Court opinion, is the leading case for establishing shareholder fiduciary duties in the close corporation context.\textsuperscript{187} In \textit{Donahue}, the court imposed a duty of utmost good faith and loyalty among shareholders in close corporations.\textsuperscript{188} Euphemia Donahue, a minority shareholder in Rodd Electrotype, brought an action seeking recision of the company’s purchase of the controlling shareholder’s shares.\textsuperscript{189} After holding that “stockholders in the close corporation owe one another substantially the same fiduciary duty ... that partners owe to one another,” the court determined that majority shareholders cannot avail themselves of the benefit of a stock repurchase without providing the same opportunity to the minority shareholders.\textsuperscript{190}

The Massachusetts Supreme Judicial Court elaborated on the fiduciary duties owed to shareholders in a close corporation (often called the \textit{Donahue} doctrine\textsuperscript{191}) in \textit{Wilkes v. Springside Nursing Home Inc.}\textsuperscript{192} In \textit{Wilkes}, the court created a test for the application of the \textit{Donahue} doctrine.\textsuperscript{193} If a controlling shareholder proves that there is a legitimate business purpose, the conduct will not violate the \textit{Donahue} fiduciary duties unless the minority shareholder can prove that there is a less harmful means of achieving that purpose.\textsuperscript{194} The \textit{Wilkes} court justified this burden-shifting approach by discussing the potential for a strict interpretation of fiduciary duties to stifle business decisions.\textsuperscript{195} Stanley Wilkes, a director and minority shareholder of the corporation, brought an action after the corporation both terminated his salary and voted him out as an officer.\textsuperscript{196} After establishing the burden-shifting standard, the court concluded that there was no legitimate business purpose for ousting Wilkes.\textsuperscript{197}

\textsuperscript{185} See \textit{Donahue}, 328 N.E.2d at 512; Pontrelli & Montgomery, \textit{supra} note 180, at 513.
\textsuperscript{186} See \textit{Donahue}, 328 N.E.2d at 512.
\textsuperscript{187} 328 N.E.2d 505. See \textit{Arnold}, \textit{supra} note 134, at 234–35.
\textsuperscript{188} \textit{Donahue}, 328 N.E.2d at 515.
\textsuperscript{189} \textit{Id.} at 508. The company refused to purchase Donahue’s shares. \textit{Id.} at 511.
\textsuperscript{190} \textit{Id.} at 515, 518–19.
\textsuperscript{191} See Pontrelli & Montgomery, \textit{supra} note 180, at 509.
\textsuperscript{192} 353 N.E.2d 657 (Mass. 1976).
\textsuperscript{193} \textit{Id.} at 663.
\textsuperscript{194} \textit{Id.; see also Arnold, supra} note 134, at 237.
\textsuperscript{195} 353 N.E.2d at 663.
\textsuperscript{196} \textit{Id.} at 658–59.
\textsuperscript{197} \textit{Id.} at 665.
The application of the *Donahue* doctrine, however, may be limited in several ways.\(^{198}\) First, these duties only apply to shareholders in a close corporation.\(^{199}\) The *Donahue* court defined a close corporation as having “(1) a small number of stockholders; (2) no ready market for the corporate stock; and (3) substantial majority stockholder participation in the management, direction and operations of the corporation.”\(^{200}\)

Next, the shareholders’ relationship to each other must be similar to that of partners.\(^{201}\) For example, in *Harris v. Mardan Business Systems, Inc.*, the Court of Appeals of Minnesota held that because plaintiff was an employee and not a partner, plaintiff was not owed fiduciary duties.\(^{202}\) The court in *Harris* analogized its holding to the fact that partners in a partnership do not owe employees fiduciary duties.\(^{203}\)

Finally, and in marked contrast to withdrawal and expulsion remedies in Germany,\(^{204}\) these fiduciary duties may be waived by the shareholders.\(^{205}\) For example, in *King v. Driscoll* and *Evangelista v. Holland*, Massachusetts courts interpreted how stock purchase agreements affect fiduciary duties.\(^{206}\) Although the court in *Evangelista* held that the stock purchase agreement would not implicate fiduciary duties,\(^{207}\) the court in *King* held that when the stock purchase agreement is triggered by conduct that violates fiduciary duties, the stock pur-


\(^{201}\) See Murdock, *supra* note 15, at 436.


\(^{203}\) *Id.* at 353. If a shareholder, however, was both an employee and a partner, that shareholder will be owed fiduciary duties. See, e.g., Wilkes v. Springside Nursing Home, Inc., 353 N.E.2d 657 (Mass. 1976) (where minority shareholder employee was owed fiduciary duties); *supra* notes 196–97 and accompanying text.

\(^{204}\) See *supra* note 106 and accompanying text.

\(^{205}\) See *Donahue* v. Rodd Electrotype Co., 328 N.E.2d 505, 518 n.24 (Mass. 1975). The *Donahue* court noted that waiver may be effectuated either through prior agreement—in the articles of incorporation or the by-laws—or through ratification. *Id.*; see also Arnold, *supra* note 134, at 240; Pontrelli & Montgomery, *supra* note 180, at 535.


\(^{207}\) 537 N.E.2d at 592–93.
Chase agreement will not insulate the controlling shareholders from liability under the *Donahue* doctrine.\(^{208}\) In *King*, the stock repurchase agreement was triggered at the end of an employee’s tenure.\(^{209}\) The *King* court concluded that the controlling shareholder’s termination of the plaintiff was a breach of fiduciary duties.\(^{210}\) However, some commentators have noted that courts may scrutinize a waiver, particularly if the drafting or execution of that waiver violates fiduciary duties.\(^{211}\)

Although several states have followed Massachusetts’ lead in fashioning protections for minority shareholders on a fiduciary duty theory,\(^{212}\) Delaware, a leading state in corporate law, has refused to apply these duties.\(^{213}\) In *Nixon v. Blackwell*, the Supreme Court of Delaware implicitly rejected the imposition of fiduciary duties on controlling shareholders in a closely-held corporation.\(^{214}\) Although the controlling shareholders in *Nixon* provided themselves with liquidity for their shares (through an employee stock ownership plan), the court held that the controlling shareholders did not have to provide the same opportunities to the minority shareholders.\(^{215}\) The *Nixon* court maintained that the only scrutiny of the controlling shareholders’ actions would be entire fairness.\(^{216}\)

\(^{208}\) 638 N.E.2d at 494.
\(^{209}\) Id. at 490.
\(^{210}\) Id. at 494. Cf. *Blank v. Chelmsford OB/GYN, P.C.*, 649 N.E.2d 1102, 1106 (Mass. 1995) (holding that where a stock purchase provision was triggered upon termination of employee and employment was terminated pursuant to an agreement that permitted termination without cause, controlling shareholder’s conduct would not violate fiduciary duties).
\(^{211}\) See *Arnold*, *supra* note 134, at 241.
\(^{212}\) See *Pontrelli & Montgomery*, *supra* note 180, at 510 & n.5.
\(^{213}\) See *Nixon v. Blackwell*, 626 A.2d 1366 (Del. 1993).
\(^{214}\) Id. at 1370, 1375–76.
\(^{215}\) Id. at 1370, 1376.
\(^{216}\) Id. at 1375–76. The “entire fairness” scrutiny takes into account two factors: fair dealing and fair price. Id. at 1376. Neither of these factors encompasses the strict fiduciary duties outlined in *Donahue*. *Compare Nixon*, 626 A.2d at 1375–76 with *Donahue v. Rodd Electrotype Co.*, 328 N.E.2d 505, 515–16 (Mass. 1975) (contrasting the strict fiduciary duties required under Massachusetts law with the fairness standard of conduct).
II. ISSUES FACING MINORITY SHAREHOLDERS IN CLOSE CORPORATIONS

A. Control

In close corporations, the shareholders often participate in the control of the corporation.217 Although this may afford minority shareholders considerable control over their investments, minority shareholders cannot generate opposition to majority shareholder decisions.218 Therefore, majority shareholders may elect to award themselves excessive compensation, fire minority shareholder employees, refuse to pay dividends, or engage in other self-interested activities.219 Coupling the ability of majority shareholders to control the corporation in ways that may adversely impact minority shareholders with the illiquidity220 of the minority’s shares, adds risk to a minority shareholder’s investment.221

For example, in the Czech Republic, the need for minority shareholder protections has been due partly to the control investment funds have exercised over investment coupons.222 Investment funds purchased many of the coupons held by Czech citizens in order to create large holding blocs in companies.223 Investment funds amassed nearly 75% of these coupons.224 Most striking is that the twelve largest investment funds (controlled predominantly by banks) administer 40% of the coupons.225 The investment funds may then use their majority position to force minority shareholders to sell their shares well below market value.226

217 See Kerry M. Lavelle, Drafting Shareholder Agreements for the Closely-Held Business, 4 DePaul Bus. L.J. 109, 109 (1991); Miller, supra note 13, at 386.
218 See Murdock, supra note 15, at 488.
219 See id. at 425; F. Hodge O’Neal, Oppression of Minority Shareholders: Protecting Minority Rights, 35 Clev. St. L. Rev. 121, 121 (1987). One commentator notes that these types of behaviors are so widespread that they constitute “a national business scandal.” O’Neal, supra, at 121.
220 See infra notes 227–30 and accompanying text.
221 See Murdock, supra note 15, at 425–26; O’Neal, supra note 219, at 125.
222 See Medicine, supra note 25; Legislative Changes, supra note 77.
223 See Medicine, supra note 25; Legislative Changes, supra note 77. Investment funds enticed coupon holders by offering to redeem coupons at ten to fifty times their value. See Balfour & Crise, supra note 46, at 94.
225 See Carroll, supra note 27, at 31. Conflicts of interest may arise because the banks that manage investment funds often play a dual role: shareholder and lender. See The New Bohemians, supra note 29, at 23. See also Carroll, supra note 27, at 23.
226 See Medicine, supra note 25; Legislative Changes, supra note 77. But see generally Carroll, supra note 27 (discussing the benefits of bank participation in company ownership).
B. Illiquidity

Shareholders in close corporations also face the problem of illiquidity.\footnote{See Miller, supra note 13, at 383, 385-86.} Illiquidity refers to the inability of a shareholder to sell or transfer his or her interest in the corporation.\footnote{See id.} The absence of a market for these shares is the predominant cause of this problem.\footnote{See id. at 385-86; Scogin, Jr., supra note 89, at 129.} Furthermore, a potential purchaser of a minority shareholder’s interest may be deterred because of the minority position the potential investor will inherit.\footnote{See supra notes 217-21 and accompanying text (discussion of control).}

C. Squeeze-outs

Squeeze-outs occur when majority shareholders seek to effectively eliminate minority shareholders from either benefiting from the corporation or participating in the business.\footnote{See O’Neal, supra note 219, at 121.} Some specific examples include refusing to pay dividends, granting excessive compensation to majority shareholder employees, depriving minority shareholders of employment with the corporation, and purchasing the minority’s shares at well below their value.\footnote{See id.} A minority shareholder’s inability to control corporate decisions prevents him or her from blocking these practices.\footnote{See supra notes 217-21 and accompanying text (discussion of control).} Furthermore, as there is minimal demand for a minority interest in a close corporation, the minority shareholder has no other means of selling his or her investment than selling at whatever price the majority will offer.\footnote{See O’Neal, supra note 219, at 121.} Therefore, the lack of control and illiquidity of a minority interest in a close corporation make minority shareholders vulnerable to squeeze-out techniques.\footnote{See Chernichaw, supra note 14, at 508-09.}

D. Enforcement

Many states have generated remedies for minority shareholders, but the costs of obtaining those remedies may be prohibitive.\footnote{See O’Neal, supra note 219, at 121.} For example, in order to bring an action in the United States, a minority shareholder must incur the expense of filing a lawsuit and paying for
an attorney.\textsuperscript{237} Although that minority shareholder may eventually obtain a judicially-supervised buyout of his or her shares, the benefits gained may be substantially reduced by the costs incurred and the effort expended.\textsuperscript{238}

The inadequacy of enforcement mechanisms may also contribute to the risks a minority shareholder faces.\textsuperscript{239} For example, the Czech Republic has statutory protections for minority shareholders, but enforcement of those protections remains a problem.\textsuperscript{240} As of February 1, 1997, the Czech Republic was still in the process of creating its Securities and Exchange Commission (SEC) to deal with enforcement of the amendment.\textsuperscript{241} The SEC will take over supervision of trading from the Ministry of Finance.\textsuperscript{242} The SEC will also be given legislative enforcement and regulatory powers.\textsuperscript{243}

Furthermore, the discretionary nature of some remedies may create uncertainty.\textsuperscript{244} For example, the broad nature of wichtige Grund in German withdrawal and expulsion remedies creates shareholder uncertainty.\textsuperscript{245} As wichtige Grund implicates personal characteristics as well as business behavior (plus other special circumstances for withdrawal actions), the myriad possibilities for demonstrating wichtige Grund create uncertainty in shareholder relationships.\textsuperscript{246}

In addition, the German judiciary's use of its discretion to achieve political ends may contribute to uncertainty.\textsuperscript{247} For example, during the Third Reich, being a Jew was wichtige Grund for expulsion.\textsuperscript{248} In 1942, two shareholders sought to expel the third share-
holder—a Jew. The shareholders seeking expulsion claimed that anti-Jewish laws would restrict the company’s activities because a Jew was a shareholder. The Supreme Court, in overturning both the district and appellate courts, concluded that Jewishness was wichtige Grund for expulsion. Although the practice of expelling Jewish shareholders was condemned after World War II, German courts still grant expulsion remedies.

Finally, if a minority shareholder succeeds in pursuing a remedy, the nature of the remedy may not adequately address the minority shareholder's loss. With regard to dissolution remedies, the minority shareholder receives value for his or her shares, but the business entity no longer exists. The profit-earning potential of the investment, along with the goodwill of the dissolved business is lost. For many minority shareholders, dissolution of the business entity also means the loss of a job and its accompanying salary.

Withdrawal of an aggrieved shareholder or a judicially-supervised buyout also negates the opportunity to share in future profits, the goodwill of the business, and employment opportunities and compensation. This remedy permits the minority shareholder to remove himself or herself from the business entity, but the majority shareholder remains free to pursue the course of conduct that led to the minority shareholder's withdrawal. Valuation of the departing shareholder's interest also creates difficulties.

Expulsion remedies may not be adequate because the minority shareholder must pay for the shares of the departing shareholder. In the event that the minority shareholder is unable to purchase the majority shareholder’s interest, the business entity will be dissolved.

249 See Entscheidungen des Reichsgerichts in Zivilsachen (Supreme Court) decision of August 13, 1942, RGZ 169, 330, 330-32 [hereinafter August 13, 1942 Decision], cited in Scogin, Jr., supra note 89, at 144 & n.66.
250 See August 13, 1942 Decision, cited in Scogin, Jr., supra note 89, at 144 & n.66.
251 See id.
252 See Miller, supra note 13, at 399; Scogin, Jr., supra note 89, at 152-53.
253 See infra notes 254-61 and accompanying text.
254 See supra notes 103, 144 and accompanying text.
255 See id.
256 See supra notes 103, 139-40 and accompanying text.
257 See supra notes 117, 173-74 and accompanying text.
258 See id.
259 See supra notes 174-78 and accompanying text.
260 See Scogin, Jr., supra note 89, at 158.
261 See id. at 159.
E. Where to Invest

Due to the globalization of corporations and the opportunities for investment abroad, investors must consider how investment protections in foreign jurisdictions will affect investment risks. From the three countries described in this Note, one can see how the protections for minority shareholders in close corporations vary. Although the perceived return on an investment may be quite high, exposure to the risks of majority shareholder dominance may diminish the attractiveness of the investment.

III. Comparative Analysis of Minority Shareholder Protections in the Czech Republic, Germany, and the United States

A. Remedies Available

In the Czech Republic, minority shareholders are protected through the recent amendments to the Commercial Code and the expulsion rights of a limited liability company. The amendments to the Commercial Code permit shareholders to obtain fair market value for their shares in the event of a takeover of the business entity. The amendments also provide for shareholder votes whenever a corporation wishes to cancel the public tradeability of shares or limit the transferability of shares. If the corporation receives the requisite vote, it must then offer to purchase the shares of those who did not vote for the change. In addition, shareholders in a limited liability company may be expelled from the company. These remedies permit the business entity to continue, but do not permit the aggrieved minority shareholder to continue in the business. Although these remedies guarantee that the minority shareholder receives fair market value, problems of valuation and the loss of future earnings and good

262 See supra notes 4–6 and accompanying text.
263 See supra notes 77–86, 101–05, 141–42, 171–72, 179 and accompanying text.
264 See, e.g., Medicine, supra note 25. Foreign investors have avoided the Czech markets because of the lack of minority shareholder protections. See id.
265 See supra notes 71, 77–86 and accompanying text.
266 See supra note 80 and accompanying text.
267 See supra note 85 and accompanying text.
268 See supra note 86 and accompanying text.
269 See supra note 71 and accompanying text.
270 See supra note 257 and accompanying text.
will place the departing minority shareholder in a disadvantageous position.\textsuperscript{271}

German minority shareholders in a GmbH are granted several remedies: dissolution, withdrawal, and expulsion.\textsuperscript{272} The dissolution remedy prevents the majority shareholder from continuing the business, so the minority shareholder faces a proportional loss.\textsuperscript{273} Minority shareholders may even be able to continue in the business without the complications of dealing with the majority shareholder if an expulsion remedy is granted.\textsuperscript{274}

In the United States, minority shareholders have been able to obtain dissolution and buyout remedies, but the basis for granting such remedies is narrower than the German \textit{wichtige Grund}.\textsuperscript{275} This is because U.S. courts, unlike the German courts, refrain from looking at the personal characteristics of shareholders when determining whether remedies should be granted.\textsuperscript{276} In addition to these remedies, some courts in the United States have recognized fiduciary duties owed to minority shareholders.\textsuperscript{277} Fiduciary duties, stemming from duties owed to partners in partnerships, are unique as compared to the Czech Republic, but they may be analogous to the German concept of \textit{wichtige Grund}.\textsuperscript{278} On the other hand, fiduciary duties contrast with German remedies because while fiduciary duties may be contractually waived by the shareholders, the rights to withdrawal or expulsion on the basis of \textit{wichtige Grund} may not be contractually waived.\textsuperscript{279}

\textbf{B. Enforcement of Remedies}

As compared to Germany and the United States, the Czech Republic has the weakest enforcement of minority shareholder protections.\textsuperscript{280} The Czech Republic was still developing its Securities and Ex-

\begin{itemize}
\item \textsuperscript{271} See supra notes 257–59 and accompanying text.
\item \textsuperscript{272} See supra notes 102, 104 and accompanying text.
\item \textsuperscript{273} See supra note 142 and accompanying text.
\item \textsuperscript{274} See supra note 119 and accompanying text.
\item \textsuperscript{275} See Miller, supra note 13, at 399.
\item \textsuperscript{276} See id. at 399.
\item \textsuperscript{277} See supra notes 179–80 and accompanying text.
\item \textsuperscript{278} See supra notes 107, 124–25 and accompanying text. Some breaches of fiduciary duties in the United States may be similar to what would constitute \textit{wichtige Grund} for withdrawal or expulsion in Germany. Compare id. with supra notes 181, 184, 188–90 and accompanying text.
\item \textsuperscript{279} See supra notes 103, 204–05 and accompanying text.
\item \textsuperscript{280} See supra notes 240–43, 283–94 and accompanying text.
\end{itemize}
change Commission by mid-1997, and the introduction of statutory minority shareholder protections did not occur until 1996. The relative novelty of the Czech Republic’s system for enforcing minority shareholder protections results in an undeveloped and untested set of protections.

Germany has a well-established system for granting minority shareholder remedies. The courts have been extremely active in this area, but the treatment of Jews during the Third Reich remains a shadow on the judicial enforcement of minority shareholder protections. The breadth of wichtige Grund has contributed to uncertainty in the law. Although judicial discretion and the broad reach of wichtige Grund permit a more flexible analysis of shareholder relationships, the uncertainty of the legal doctrine may adversely affect these relationships.

The United States does not have a uniform system for enforcing minority shareholder protections because each state within the United States enacts its own legislation. Some jurisdictions within the United States, however, have developed broad bases for granting minority shareholder remedies. In Illinois, oppressive conduct (a basis for granting dissolution) only requires a finding of heavy-handed or arbitrary conduct. New York’s reasonable expectations standard (a basis for granting a buyout) allows a court to consider the bargain of the parties. Finally, Massachusetts fiduciary duties allow a court to probe into the good faith and loyalty of the shareholders. Both the number of remedies that may be available, and the broad scrutiny used to determine whether remedies should be granted provide U.S. courts with similar enforcement power and discretion as German courts.

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281 See supra notes 77, 241 and accompanying text.
282 See supra notes 240–43 and accompanying text.
283 See supra notes 99–132 and accompanying text.
284 See supra notes 248–51 and accompanying text.
285 See supra notes 245–46 and accompanying text.
286 See supra notes 245–52 and accompanying text.
287 See supra notes 245–52 and accompanying text.
288 See Blackburn, supra note 3, at 49.
289 See supra notes 149–53 and accompanying text.
290 See supra note 161 and accompanying text.
291 See supra note 188 and accompanying text.
292 See supra notes 141–42, 171–72, 179 and accompanying text.
293 See supra notes 146, 150–54, 160–61, 163–65, 181, 190, 194 and accompanying text.
294 See supra notes 102, 107, 125 and accompanying text.
C. Adequacy of Remedies

The Czech Republic's remedies do not appear to adequately protect minority shareholders.\textsuperscript{295} Although shareholders in a limited liability company may be expelled, and shareholders may seek fair market value in the event of a takeover, shareholders have no other option but to take the money and leave the company.\textsuperscript{296} Furthermore, buyout remedies are only triggered upon takeovers, cancellation of the public tradeability of shares, or limitation of share transferability.\textsuperscript{297} As the Czech Republic is trying to attract investors, particularly foreign investors, allowing only the option of expulsion or buyout removes the incentive to make the effort to invest in the first place.\textsuperscript{298} This is most contrary to one of the goals of the Commercial Code: fostering public confidence in capitalism and private business ownership.\textsuperscript{299} Czech citizens have only recently been introduced to the investment arena.\textsuperscript{300} If their first glimpses of shareholding are dominant investment funds capable of controlling business decisions and illiquid shares, they may be unwilling to enter the investment arena again.\textsuperscript{301} Foreign investors, with their numerous opportunities for investment in other countries, will seek more protective states.\textsuperscript{302}

German minority shareholders appear to be adequately protected—they are afforded several remedies and a broad means through which to obtain them.\textsuperscript{303} The problem, however, is that the remedies available to minority shareholders may also be used against them.\textsuperscript{304} As wichtige Grund may be established based on personal characteristics of a shareholder, majority shareholders might try to expel a minority shareholder for one of these characteristics—being uncooperative, for example.\textsuperscript{305}

The adequacy of remedies in the United States varies depending on the state in which the business entity is formed.\textsuperscript{306} In general, the major failure of remedies in the United States is that courts have been

\textsuperscript{295} See infra notes 296–302 and accompanying text.
\textsuperscript{296} See supra notes 79–86, 257–58 and accompanying text.
\textsuperscript{297} See supra notes 79–80, 85–86 and accompanying text.
\textsuperscript{298} See supra notes 257–58 and accompanying text.
\textsuperscript{299} See Black & Kraakman, supra note 5, at 1913.
\textsuperscript{300} See supra notes 58–64 and accompanying text.
\textsuperscript{301} See Black & Kraakman, supra note 5, at 1913.
\textsuperscript{302} See supra notes 4–6 and accompanying text.
\textsuperscript{303} See supra notes 99–111, 119–25 and accompanying text.
\textsuperscript{304} See supra note 119 and accompanying text.
\textsuperscript{305} See supra notes 107, 125 and accompanying text.
\textsuperscript{306} See Blackburn, supra note 3, at 49.
unwilling to expel a heavy-handed majority shareholder.\textsuperscript{307} From a minority shareholder’s point of view, either the minority shareholder can seek dissolution or a buyout (thereby losing all hopes of future profits and participation), or the minority shareholder can remain with the corporation with the majority shareholder (possibly seeking damages based on violations of fiduciary duties).\textsuperscript{308} In neither of these scenarios may a minority shareholder continue in the business without the heavy-handed majority shareholder.\textsuperscript{309}

IV. SUGGESTIONS FOR IMPROVING MINORITY SHAREHOLDER PROTECTIONS IN THE CZECH REPUBLIC

In order to alleviate some of the deficiencies of minority shareholder protections and attract foreign investors, the Czech Republic should adopt several aspects of minority shareholder protections already established by Germany and the United States.\textsuperscript{310} If German and U.S. investors look to the Czech Republic and find similar protections to those in their home states, they may feel more comfortable making an investment there.\textsuperscript{311} Increasing minority shareholder protections, therefore, may attract foreign investors and enable the Czech Republic to compete with Poland and Hungary.\textsuperscript{312}

A. The Relationship Between the Czech Republic, Germany, and the United States

Several factors point to Germany and the United States as candidates for emulation by the Czech Republic.\textsuperscript{313} First, Germany and the United States rank first and second respectively in foreign investment in the Czech Republic.\textsuperscript{314} German investment accounts for 30\% of the total foreign investment, and the United States accounts for 14\%.\textsuperscript{315} Germany has already been moving capital and technology into the Czech Republic because of the low wages there.\textsuperscript{316}

\textsuperscript{307} See supra note 121 and accompanying text.
\textsuperscript{308} See supra notes 141, 171–72, 179 and accompanying text.
\textsuperscript{309} See id.
\textsuperscript{310} See infra notes 325–38 and accompanying text.
\textsuperscript{311} See, e.g., Blackburn, supra note 3, at 9 (discussing how unification of corporate laws may facilitate cross-border transactions).
\textsuperscript{312} See Medicine, supra note 25.
\textsuperscript{313} See infra notes 314–24 and accompanying text.
\textsuperscript{314} See Pivnicka & Kreisl, supra note 17, at 6.
\textsuperscript{315} See id.
\textsuperscript{316} See Medicine, supra note 25.
Next, the Czech Republic has already looked to Germany and the United States as models for change. The Czech Republic's corporation laws closely model U.S. and German corporation laws. The Czech Republic planned to create its Securities and Exchange Commission partly based on the U.S. Securities and Exchange Commission. Furthermore, as a condition for providing much needed capital, U.S. institutions have demanded that host countries assimilate to their styles of doing business. According to Mr. Richard Salzman, head of the Prague Stock Exchange, "[Czechs] speak English, we take advice from Americans, but look at the map. We are going towards the German system."

Finally, as Germany is a dominant member of the European Union, and the Czech Republic is currently seeking admission into the European Union, emulating German standards may make transition into the European Union easier. Already, the Czech Republic has signed an association agreement with the European Union. During the term of this agreement, the Czech Republic has begun to bring its laws into compliance with European Union guidelines.

B. Improving Shareholder Protections in the Czech Republic—Providing Broader Bases for Buyout Remedies

In order to improve shareholder protections, the Czech Republic may wish to broaden the availability of buyouts. Currently, buyouts are only available in the context of takeovers or corporate actions to cancel the public tradeability of shares or limit the transferability of

317 See, e.g., id.
319 See Medicine, supra note 25.
320 See Speeckaert, supra note 4, at 38.
321 See The New Bohemians, supra note 29.
322 See Breskovski, supra note 318, at 78–79.
323 See generally, Europe Agreement establishing an association between the European Communities and their Member States, of the one part, and the Czech Republic, of the other part, 1994 O.J. (L 360/2), as amended by 1996 O.J. (L 343/1) and explained in 1997 O.J. (C 141/5), available in ENCYCLOPEDIA OF EUROPEAN UNION LAW, vol. 3, § 43.2660, et seq.
324 See Breskovski, supra note 318, at 79.
325 See supra notes 79–86 and accompanying text.
shares.\textsuperscript{326} In both Germany and the United States, buyouts are available when conduct of a majority shareholder becomes intolerable.\textsuperscript{327}

Broadening the availability of buyouts and imposing fiduciary duties on shareholders, however, implicates a need to develop judicial standards for those concepts.\textsuperscript{328} Furthermore, the Czech Republic will have to establish a procedure for review.\textsuperscript{329} Within the past five years, both the Ministry of Finance and the Securities and Exchange Commission have played a role in overseeing the trading of shares.\textsuperscript{330} In addition to granting oversight powers to the Ministry of Finance or the Securities and Exchange Commission, the Czech judiciary could be granted a role in review.\textsuperscript{331}

Although dissolution may be considered as an alternative remedy, the Czech Republic's need to support competitive enterprises, thereby enhancing its market economy and inspiring investor confidence, may preclude this remedy.\textsuperscript{332} Upon dissolution, the corporate entity ceases to exist.\textsuperscript{333} Even with expulsion, if the minority shareholder does not have sufficient capital to compensate the expelled majority shareholder, the corporation will be dissolved.\textsuperscript{334} As the Czech Republic wants to encourage business, it may not want to introduce remedies that destroy business.\textsuperscript{335}

Perhaps the most effective way to institute change will be to adopt an amendment to the Commercial Code.\textsuperscript{336} This is the means by which the Czech Republic adopted its most recent minority shareholder protections.\textsuperscript{337} As the Commercial Code governs business activities, passing an amendment to the Commercial Code to provide broader bases for buyouts is an adequate means to both protect minority shareholders and inspire investor confidence.\textsuperscript{338}

\textsuperscript{326} See id.
\textsuperscript{327} See supra notes 107–11, 168 and accompanying text.
\textsuperscript{328} See, e.g., supra notes 107–10, 124, 127, 147–67, 187–211 and accompanying text (discussing the development of judicial standards in Germany and the United States).
\textsuperscript{329} See, e.g., supra notes 112–15, 128–32 and accompanying text (discussing the procedure for obtaining withdrawal or expulsion in Germany).
\textsuperscript{330} See supra note 242 and accompanying text.
\textsuperscript{331} See supra notes 242–43 and accompanying text.
\textsuperscript{332} See Black & Kraakman, supra note 5, at 1913; supra note 38 and accompanying text.
\textsuperscript{333} See supra notes 144, 254–56 and accompanying text.
\textsuperscript{334} See supra notes 260–61 and accompanying text.
\textsuperscript{335} See supra notes 332–34 and accompanying text.
\textsuperscript{336} See supra notes 37–40, 77–86 (discussing the Commercial Code of the Czech Republic and recent amendments affording some minority shareholder protections).
\textsuperscript{337} See supra note 77 and accompanying text.
\textsuperscript{338} See supra notes 38–39 and accompanying text.
CONCLUSION

Protecting investors is generally a task left to state legislative and judicial actions. The globalization of investments, however, presents an added question to these law-making bodies—how will investor protections affect foreign investment decisions? Particularly with emerging economies—economies starved for investment from developed states—this issue may impact the success of their transformations from planned economies to viable market economies. This Note has focused on one set of investor protections—protections for minority shareholders in close corporations—to see what lessons emerging economies may import from developed economies. After discussing the dearth of remedies available to minority shareholders in the Czech Republic, Germany, and the United States, this Note concludes that the Czech Republic should adopt an amendment to its Commercial Code that will provide broader bases for obtaining buyout remedies. With the implementation of minority shareholder protections derived from developed countries, such as the one suggested above, emerging economies may ease the fears of foreign investors and attract the capital necessary for economic growth.

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