Exploitation among Close Corporation Shareholders: A Philosophical Change and Its Consequences

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EXPLOITATION AMONG CLOSE CORPORATION SHAREHOLDERS: A PHILOSOPHICAL CHANGE AND ITS CONSEQUENCES

The somewhat unanticipated increase in the use of the corporate form by small groups of entrepreneurs has prompted questions concerning the feasibility of applying traditional corporate law to private small business corporations, referred to as "closely held corporations." Although the close corporation is clothed with corporate status, the current view is that its actual operation and internal structure more closely resemble that of a partnership. Accordingly, the legislative and judicial reaction has been to forego corporate law principles in favor of partnership law standards when confronted with situations where close corporation shareholders take action adverse to the interests of their partner-shareholders. The interjection of partnership principles to corporate situations underscores the belief that these specific problems cannot be resolved without affecting traditional corporate frameworks and concepts.

This comment analyzes the various characteristics of a closely held corporation and the application of partnership law principles to such corporations in situations involving corporation squeeze-outs. Current judicial and legislative developments dealing with squeeze-outs and other oppressive conduct are examined with particular emphasis accorded to the fiduciary relationship existing among shareholders in a close corporation setting.

DEFINING THE CLOSE CORPORATION

The most common corporate form in the United States is the close corporation. A close corporation will frequently originate as a partnership or sole proprietorship. By in-
corporating, the owners of such a business hope to gain the advantages of the corporate form such as limited liability, tax savings, free transferability of interests and perpetual existence, while retaining the internal structure of the partnership or sole proprietorship.

Thus, in a close corporation there are typically a small number of shareholders who, despite their corporate form, continue to regard themselves as partners. These "partner"-shareholders continue to actively participate in the day-to-day management of the enterprise. In doing so, they exercise a substantially identical control of ownership and management. This is in direct contrast with the conventional concept of corporation law where the ownership and management of a corporation are divided between the shareholders and the board of directors.

Due to their close working relationship, the shareholders depend heavily on the cooperative efforts and mutual confidence of each other for the success of the enterprises. "[B]ickering, corporate stalemates, and perhaps efforts to achieve dissolution" will threaten the viability of the corporation. To assure the succession in interest of persons most likely to work harmoniously with the other shareholders, the close corporation will often restrict the transferability of its stock. Thus, close corporations reject the

3. To be eligible for Subchapter S treatment, which permits certain corporations to have their annual income taxed only to the shareholders and not to the corporation, the corporation must limit the number of its shareholders to fifteen. I.R.C. § 1373(a)(1), 26 U.S.C. § 1371(a)(1) (Supp. 1979). However, some state statutes define a close corporation such that as many as thirty persons may hold stock in the corporation. See, e.g., DEL. CODE ANN. tit. 8, § 342(a)(1) (1974).


5. See, e.g., Thisted v. Tower Management Corp., 147 Mont. 1, 409 P.2d 813, 820 (1966) where the court defined a close corporation as one in which the judgment of the directors is not independent from that of the shareholders.

6. In the conventional setting, shareholders elect the board of directors. The directors manage the corporation by establishing corporate policy and appointing officers to execute such policy. Inherent in such an approach is the separation of ownership by the shareholders from management power vested in the board of directors. HENN, supra note 4, at § 188.


corporate norm of free transferability of shares, often in favor of the partnership model which requires the consent of all existing partners for the admission of a new partner.9

Unlike public-issue corporation stock, close corporation stock is not publicly traded10 and, due to share transfer restrictions, it is not usually traded in the private sector. It is therefore extremely difficult to determine the value of close corporation stock.11 As a result, close corporation minority stock has a poor market value, if one at all.12 Consequently, the remedies available to minority interests in public-issue corporations are not available to close corporation minority interests. A dissatisfied public-issue shareholder can sell his shares and recover his invested capital. However, a dissenting close corporation shareholder has no such remedy. "No outsider would knowingly assume the position of the disadvantaged minority. To cut losses, the minority stockholder may be compelled to deal with the majority."13

CURRENT JUDICIAL AND LEGISLATIVE DEVELOPMENTS

Due to these peculiarities, statutes and case law have recently begun to recognize that close corporations may in fact function upon an entirely different basis than public-issue corporations, and are therefore to be accorded distinct treatment.14 Recognition of the need for extraordinary treatment for closely held corporations is, in fact, recognition of the need for an alteration in the conceptual framework of corporate existence. For instance, in an appropriate case, a court might not hold a close corporation to the strict for-

9. Uniform Partnership Act § 18(g).
10. The close corporation is not permitted to offer any of its stock which would constitute a "public offering" within the meaning of the United States Securities Act (1933), 15 U.S.C. § 77a. et. seq. (1976).
11. Henn, supra note 4, at § 281.
12. Cary, supra note 4, at 469.
14. "[T]here has been a definite, albeit inarticulate, trend toward eventual judicial treatment of the close corporation as sui generis." Galler v. Galler, supra note 13, at 584. See also Kruger v. Gerth, 16 N.Y.2d 802, 806, 263 N.Y.S.2d 1, 4 (1965) (Fuld, J. dissenting).
malities applicable to a public-issue corporation, and mere irregularities may be permitted, at least where no fraud or injury would be worked upon the public, minority interests or creditors.\textsuperscript{15} The law has also become more tolerant of the close corporation’s departure from the principle of free alienability of shares.\textsuperscript{16} This tolerance permits close corporation planners to provide for the necessary share transfer restrictions.

However, the law has not always been so tolerant of deviations from the statutory norm. All corporations were, and to some extent still are, governed by the same statutory provisions designed for public-issue corporations.\textsuperscript{17} A typical and classic view was that

\[\text{[t]he law never contemplated that persons engaged in business as partners may incorporate, with intent to obtain the advantages and immunities of a corporate form, and then, Proteus-like, become at will a copartnership or a corporation, as the exigencies or purposes of their joint enterprise may from time to time require. . . . They cannot be partners inter sese and a corporation as to the rest of the world.}\textsuperscript{18}

However, the concept of the corporate entity as a separate legal personality is not entirely valid. There appears to be little question that, in many instances, a distinction has been made between publicly held and closely held corporations.\textsuperscript{19}

A growing number of states are adopting statutes specifically designed to give special attention to the legit-
imate needs of close corporations. 20 For instance, the statutes will often permit the close corporation to confer management authority directly on the shareholders, thus bypassing the traditional role of the directors. 21 Other states, including Wyoming, have adopted the provisions of the Model Business Corporation Act 22 which is said to provide sufficient flexibility for ease of creation and management of a close corporation without the problems often associated with the statutory provisions designed specifically for the governing of closely held corporations. 23

MINIMUM RIGHTS FOR CLOSE CORPORATION PARTICIPANTS

It is apparent then, that for many purposes the close corporation is not treated in the conventional manner, as a mere entity with a personality unto itself, separate and distinct from the individual shareholders. Although the close corporation is clothed with corporate status, the current view is that its actual operation and internal structure more closely resembles that of a partnership with its attendant strict fiduciary relationship of trust and confidence. Thus, the fiduciary duties owed among close corporation members are quite different and much more stringent than those owed among the participants in a publicly held corporation.

Under traditional corporate theory, it has often been held that a director or majority shareholder owes a fiduciary obligation to the corporation. 24 Yet the courts have typically been reluctant to hold that, absent special circumstances, 25

23. Preface to 1969 revision of the Model Business Corporation Act (stating the position taken by the Committee on Corporate Laws of the American Bar Association).
there exists a fiduciary duty vis-a-vis the minority shareholders.\textsuperscript{26} Thus, a majority shareholder does not, merely because of his stock ownership, owe a fiduciary duty to the minority shareholders.\textsuperscript{27} Even when a fiduciary relationship has been held to exist, the duty imposed has been considerably less than that imposed on partners and joint venturers. Therefore, in the absence of some kind of control agreement that affords each of the close corporation members special protection, the members occupy a vulnerable position.

However, the trend now is to impose a fiduciary duty among close corporation members that requires more than merely acting at arm's length.\textsuperscript{28} "Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior."\textsuperscript{29} Accordingly, the courts have begun to for-sake corporate law principles in favor of the stricter partnership standards in situations where close corporation shareholders take action adverse to the interests of their partner-shareholders.\textsuperscript{30}

The 1975 decision, \textit{Donahue v. Rodd Electrotype Company of New England},\textsuperscript{31} gave recognition by doctrinal innovation that the duty owed among close corporation members is the same fiduciary duty that partners owe to one another. There the Rodd Electrotype Co., a closely held corporation, purchased shares from Harry Rodd, the former controlling

\begin{enumerate}
\item[27.] \textit{See}, e.g., Swinney v. Keebler Co., 480 F.2d 573, 577 (4th Cir. 1973); McDaniel v. Painter, 418 F.2d 545, 547 (10th Cir. 1969) (Kansas law); Cundick v. Broadbent, 383 F.2d 157 (10th Cir. 1967) (Wyoming law), \textit{cert. denied} 390 U.S. 948 (1968).
\item[28.] In Jones v. H. F. Ahmanson & Co., 1 Cal. 3d 93, 111, 460 P.2d 464, 473, 81 Cal. Rptr. 592, 601 (1969), Justice Traynor noted:
\begin{quote}
The increasingly complex transactions of the business and financial communities demonstrate the inadequacy of the traditional theories of fiduciary obligation as tests of majority shareholder responsibility to the minority. These theories have failed to afford adequate protection to minority shareholders and particularly to those in closely held corporations ... 
\end{quote}
\item[29.] Courts often incorporate by reference the standard of duty applied to joint venturers and partners, as elucidated by Chief Judge Cardozo in Meinhard v. Salmon, 249 N.Y. 458, 465-466, 164 N.E. 545, 546 (1928).
\item[30.] Oppressive conduct within the close corporation is most often described as a "freeze out" or "squeeze-out." \textit{ONEAL}, \textit{supra} note 1, § 1.01 at 1.
\item[31.] \textit{Donahue v. Rodd Electrotype Co. of New England}, \textit{supra} note 7.
\end{enumerate}
stockholder. The plaintiff learned of the purchase and subsequently offered her shares for sale to the corporation at the price paid to Rodd. When her offer was refused she brought suit to rescind the purchase.

The court began its analysis by noting that because of the small number of shareholders, the restricted market for the shareholders' stock, the participation by the shareholders in the management and operation of the business, and the dependency of the shareholders on one another for the success of the enterprise, "the close corporation bears striking resemblance to a partnership."32 The court further observed that minority close corporation shareholders are particularly vulnerable to squeeze-outs and other oppressive conduct for which there is no adequate remedy under the traditional rules.33 For instance, application of the majority rule doctrine would effectively assist the controlling shareholders to eliminate the minority interests. The business judgment rule would operate in a similar fashion; its effect would be to sustain actions taken by the directors. Furthermore, the close corporation shareholder's remedies are limited by the unavailability of dissolution and the lack of a ready market for close corporation securities.34

These two themes, lack of adequate remedies and partner-like corporate citizenship, led the court to determine that "stockholders in the close corporation owe one another substantially the same fiduciary duty in the operation of the enterprise that partners owe to one another," rather than "the somewhat less stringent standard of fiduciary duty to which directors and shareholders of all corporations must adhere."35 The court then imposed the strict standard of "utmost good faith and loyalty"36 and ruled that Rodd must cause the corporation to offer each shareholder an equal

32. Id. at 512.
33. Id. at 513-515.
34. Id. at 514, 515.
35. Id. at 515, 516 (footnotes omitted).
36. Id. at 516.
opportunity to sell his shares to the corporation at an identical price.87

In addition to the stricter fiduciary standard, the Massachusetts court made another significant departure from the traditional notion of corporate fiduciary duty by imposing the strict standard on all members of close corporations, without regard to status as a majority or minority shareholder, and without regard to official capacity as an officer or director.88 In doing so, the court implicitly made the practical observation that the usual close corporation setting involves shareholders who also serve as officers and directors—an individual will exercise management control as well as ownership.

It should be understood that the Donahue facts do not reveal an attempted freeze-out. Nevertheless, the court ordered the corporation to offer the plaintiff an equal opportunity to sell her shares. It would seem that the court was more concerned with the potential for oppression in a close corporation, and that the holding was at least partially motivated by a desire to protect other shareholders in future cases.

While both the standard and the result of its application in Donahue are clear, its true import depends on judicial application in subsequent cases. Later case law dealing with squeeze-outs and other oppressive conduct is examined below and explores the application of the Donahue standard in squeeze-out situations.

37. Id. at 518. Other courts have also suggested the equal opportunity concept as a remedy for breach of fiduciary duties involved in the sale of shares. See, e.g., Jones v. H. F. Ahmanson & Co., supra note 28 at 473.
38. Accord: Comolli v. Comolli, 241 Ga. 471, 246 S.E.2d 278, 280-81 (1978) (directors' action in causing corporation to purchase shares in the company from the widow of one shareholder constituted a breach of duty owed to all close corporation shareholders unless the director would authorize the corporation to purchase the minority shareholder's interest on the same terms); Helms v. Duckworth, 249 F.2d 482 (D.C. Cir. 1957) (minority shareholder held to have violated a similarly defined duty by not renegotiating the purchase price contained in a buy-sell agreement with the majority shareholder).
One year after its Donahue decision, the Massachusetts court decided Wilkes v. Springside Nursing Home, Inc., and again indicated a willingness to break with traditional concepts governing corporate behavior. After consulting an attorney, Wilkes and his three partners organized a corporation under Massachusetts law. Each of the four partners invested an equal amount of capital, and subscribed to an equal number of shares in the corporation. At the time of incorporation, it was understood that each owner would serve as a director and would actively participate in the management of the corporation. It was also agreed that each would share equally in the earnings. However, they did not enter into a formal shareholders' agreement allocating control and earnings.

Eventually, the relationship between Wilkes and the other three shareholders deteriorated. As a consequence, the controlling shareholders removed Wilkes from the board of directors and discharged him from the company's employ. There was no indication that the termination of Wilke's employment was based on his misconduct or neglect of duties.

The court held that the majority shareholders had breached their fiduciary duties owed to Wilkes. In doing so, the court relied heavily on the prior Donahue decision and again imposed the partnership standard of "utmost good faith and loyalty." The court noted that Wilkes entered the corporation with the expectation that he would continue to actively participate in its affairs, and that the majority's action effectively frustrated his expectation.

Although the court recognized that the squeeze technique of depriving minority shareholders of corporate offices and employment has been facilitated by the business judg-

40. Id. at 663, 665.
41. Id. at 662-663.
ment rule, it nonetheless cautioned that the fiduciary standard is to be tempered with the business judgment rule. The court felt that strict application of the fiduciary standard in situations such as this must be avoided and that a balance must be struck between the majority’s fiduciary obligations and the majority’s right to control the corporation.

The importance of the Wilkes decision cannot be overemphasized. Although the court did make an inquiry as to whether the majority could demonstrate a legitimate business purpose for their action, it did not exhibit the traditional reluctance to closely examine the business judgment of the directors, such as the selection and retention or dismissal of officers, directors and employees.

Under conventional corporation law, the squeezed minority shareholder must bear the burden of proving that the controlling shareholders or the directors have acted improperly. However, in Wilkes, the burden was shifted to the majority to show a legitimate business purpose. Only a showing of actual misconduct by an “undesirable individual bent on injuring or destroying the corporation” would justify the majority’s action of removing a minority shareholder from his corporate directorship and employment.

Conceivably, the court’s decision was influenced by the fact that although the shareholders had an understanding

42. Id. at 662. See, BALLANTINE, CORPORATION § 231 (rev. ed. 1946) wherein it is said that “courts hesitate to substitute their judgment on complicated questions of business policy for that of the elected managers of the business and have limited the scope of judicial review which they are willing to undertake.” This lack of judicial participation works as a barrier to the granting of relief to squeezed shareholders. O’Neal, supra note 1, § 3.03 at 59.
44. Id.
45. Id. at 662. Other modern courts have also demonstrated a tendency to limit the scope of the business judgment rule. See Cramer v. General Telephone & Electronics Corp., 582 F.2d 259, 275 (3rd Cir. 1978), cert. denied 439 U.S. 1129 (1978).
47. Wilkes v. Springside Nursing Home, Inc., supra note 39 at 663, 664. The shifting of the burden is entirely consistent with partnership principles. When there is a question of breach of a fiduciary duty of a managing partner all doubt will be resolved against him, and he has the burden of proving his innocence. Bovy v. Graham, Cohen and Wampold, 17 Wash. App. 567, 564 P.2d 1175, 1178 (1977); Conrad v. Judson 465 S.Wa.2d 819, 828 (Ct. App. 1971).
that control and earnings were to be shared equally, they did not enter into a formal shareholders' agreement providing for equality. Poor planning for close corporations is a frequent situation, and often provides a legally sanctioned blueprint for squeeze-outs. While nothing can replace adequate planning and the foresight to write protective provisions into the corporate charter, bylaws or shareholders' agreements, Wilkes offers a second protection to assist the shareholder by protecting the reasonable expectations of the parties.

However, to look to the parties' expectations is contrary to the Donahue assumption that a relationship of "trust and confidence" exists in all close corporations. Thus, Donahue defined a duty applicable to all close corporation shareholders, regardless of the existence of other factors. Nevertheless, Wilkes teaches us that there are instances where the imposition of duties analogous to those owed by partners may violate the intentions of the parties.

The reasoning in Cressy v. Shannon Continental Corp. closely parallels that of Wilkes. Both avoided the Donahue assumption that the strict fiduciary relationship arises in all corporations that are closely held; again the inference being that imposition of the partnership concept may, in some situations, be contrary to the intention of the shareholders.

The Cressy v. Shannon litigants, each a principal shareholder, had failed to disclose to the other the availability of outstanding shares for purchase and to afford the opportunity to share in the purchase of such stock. The court looked to the expectations of the parties and found that they

49. O'Neal, supra note 1 § 2.17 at 48-50.
50. Wilkes v. Springside Nursing Home, Inc., supra note 39, at 662-664. See also O'Neal, supra note 1, § 7.15 at 523: "Closely related to the notion that a close corporation is similar to a partnership and in many respects should be governed by the same rules is the idea that at least some close corporations are companies based on personal relationships that give rise to expectations that the courts should protect."
52. "We do not suggest the relationship arises a fortiori in a corporation involving few shareholders. Such parties may well intend to do business with the world and among themselves strictly in accord with the norms of general corporation law." Id. at 945, n. 6.
had intended an equal division of ownership and control.\textsuperscript{53} The intention to commit themselves equally to the enterprise was held to be analogous to the partnership expectation of equality, and therefore the stricter partnership duty was imposed.\textsuperscript{54}

The difficulty associated with determining intent is compounded because of the need to determine which fiduciary duty should be applied. The problem is well illustrated in \textit{Johns v. Caldwell},\textsuperscript{55} a case dealing with a double squeeze-out situation involving all three of the corporation's shareholders.\textsuperscript{56} The majority shareholders, Johns and Caldwell, had for some years controlled the corporation in a contemptible manner, without regard for Moore, the minority shareholder. Finally Moore could endure no more and decided to sell his stock. He made an offer to Caldwell, but neither informed Johns of the offer. Once Johns did learn of the offer, he brought action to prevent the sale or, in the alternative, to require that the sale of Moore's stock be equally divided among Johns and Caldwell.

Johns alleged that he and Caldwell had always operated the business as a partnership; therefore, there should exist a strict fiduciary relationship.\textsuperscript{57} However, the court determined that the business functioned not as a partnership, but as a corporation.\textsuperscript{58} It was characterized as such since it had performed the necessary formalities associated with corporate demeanor.\textsuperscript{59} The traditional rule was then applied, that a shareholder may dispose of his stock as he pleases.\textsuperscript{60} Accordingly, judgment was rendered in favor of Caldwell and Moore.

\textsuperscript{53} \textit{Id.} at 943, 945.

\textsuperscript{54} \textit{Id.} at 945.

\textsuperscript{55} Johns v. Caldwell, 601 S.W.2d 37 (Tenn. App. 1980).

\textsuperscript{56} The stock distribution was as follows: Johns—45\%, Caldwell—45\%, Moore—10\%. \textit{Id.} at 39.

\textsuperscript{57} \textit{Id.} at 41.

\textsuperscript{58} \textit{Id.}

\textsuperscript{59} "Directors' meetings have been held, minutes have been kept, corporate tax returns have been filed and dividends have been declared. All of these activities are indicative of a corporate form of business." \textit{Id.}

\textsuperscript{60} \textit{Id.} at 42, citing State \textit{ex rel.} Lowell Wiper Supply Co. v. Helen Shop, Inc., 211 Tenn. 107, 362 S.W.2d 787 (1962).
It is the author's opinion that whether a corporation performs the necessary corporate rituals is irrelevant to the issue of duty owed. All corporations, regardless of their nature, are required to conduct meetings, keep minutes and file tax returns. The court's reliance on these incidents was misplaced. A more proper inquiry would be whether the shareholders had regarded themselves as partners. Thus, in Johns the issue of intent should have been explored more thoroughly before the court could determine whether the duty of "utmost good faith and loyalty" was applicable.61

However, the question arises whether it is necessary or even helpful for a court to determine the parties' intentions before deciding which standard shall apply. It is arguable that while the imposition of a strict fiduciary duty analogous to that owed by partners may exceed the intentions of the parties, this approach may be justified as a matter of policy. The courts' application of the stricter duty in a close corporation setting would be more certain and less costly than an approach which would attempt to assess the nature of the relationship between the close corporation participants after an examination of all the circumstances surrounding its creation, development and breakdown. Were the rule otherwise, the issue of intent would often have to be litigated before it is apparent whether the stricter duty applies at all.

However, the effect of a rule imposing the fiduciary relationship on unwilling and unsuspecting parties without regard for their expectations would be patently unfair and somewhat tyrannical. Perhaps a more satisfactory solution would be for the courts to develop a system of logic based on the rights as well as the expectations of those people associated with the close corporation. Such a methodology would offer sufficient flexibility to apply, in appropriate situations, not only to the close corporation shareholders, but also to certain third parties who deal with the corporation.

61. Similarly, other courts deal with the issue of duty owned by close corporation shareholders by determining on an ad hoc basis the nature of the shareholders' relationship. See, e.g., Murphy v. Country House, Inc., 307 Minn. 344, 240 N.W.2d 507, 512 (1976) where the court ruled that the shareholders had not acquired any fiduciary relationship of fact.
By definition, the third party would not be in a position to assert his membership in the personal relationships deserving of the courts' protection. Yet without the protection of strict fiduciary duties, the outsider may find himself on the short end of a scheme to "milk the big cow"—with no remedy available. The third party would be protected only in those instances where the court chooses to look to his rights and expectations and expand the fiduciary relationship to cover outside interests.

*Toledo Trust Co. v. Nye* is such a case. The close corporation held an option to repurchase the shares of a deceased holder at fair market value. The corporation exercised its option and negotiated a price with the deceased's representative without disclosing that another company was negotiating to purchase the corporation for a high price. The defendants argued in favor of the traditional rule requiring common law fraud. However, the court held that it was not necessary to show fraud since there existed a strict fiduciary relationship among the shareholders. The court further determined that the fiduciary duty did not die with Ritter, the deceased, but survived to his personal representative, the plaintiff.

The traditional corporate practice is to think in terms of rights attaching to shares of stock instead of to people. The compelling need and logic for rights to be enjoyed by those people who participate in or deal with a close corporation cannot be understated. The following section is illustrative of the trend to shape workable remedies such that the rights afforded may be protected.

**Judicial Remedies for Oppression**

By not insisting on appropriate protective provisions written into the corporate charter, bylaws or shareholders'
agreement, a close corporation participant often places himself in a precarious position, vulnerable to squeeze-out or oppression. Although the courts have generally been somewhat conservative in shaping remedies for oppressed close corporation shareholders, steps have been taken to provide relief.

In particular, there has been a noticeable improvement in the shaping of relief where the majority has squeezed the minority by the common technique of withholding payment of dividends over a long period of time. Of course, if the minority can prove that dividends were withheld solely to effect a freeze-out, a court might compel the declaration of dividends. But that remedy is not entirely satisfactorily—once the dividend has been declared, there is usually nothing to prevent the majority from repeating the offense. If convinced that repeated offenses are likely, courts will sometimes liquidate the corporation; but they hesitate to do so because of the economic waste involved in forced liquidations, particularly in the case of a solvent corporation.

A Michigan appellate court upheld a unique decree designed to relieve minority shareholders of the necessity of repeatedly bringing successive suits in order to obtain dividends. The court stated that it could compel the payment of dividends if the directors' refusal to do so constituted a breach of fiduciary duty. In determining whether dividends should be declared, the court gave considerable atten-

66. Close corporation shareholders have a means of protection not available to public-issue corporation shareholders. They may limit by way of private agreement the power of the controlling shareholders to exercise unilateral control of the corporation or they may guarantee the minority a return on its investment. See Galler v. Galler, 32 Ill.2d 16, 203 N.E.2d 577 (1964); Clark v. Dodge, 269 N.Y. 410, 199 N.E. 641 (1936). Even so, it is impossible for even the most conscientious business planner to foresee the infinite variety of squeezes and guard against each squeeze technique.

67. O'Neal, supra note 1, § 9.05 at 588.

68. The majority shareholders will often attempt to escape the hardships associated with the withholding of dividends by increasing the compensation paid to themselves as employees of the corporation. O'Neal, supra note 1, § 3.07 at 86.

69. See Morrison v. State Bank of Wheatland, 58 Wyo. 138, 126 P.2d 793 (1942) where the court ruled that it does have the power to declare dividends where the directors act fraudulently, oppressively or unreasonably.

70. Cary, supra note 4, at 483.

tion to the company’s profits and future needs, but placed special emphasis on the fact that the close corporation directors were also corporate officers receiving compensation. As such, they were not in a position to make an impartial decision as to whether a dividend should be declared. The court then ordered dividends to be paid for the previous five years and retained jurisdiction for the subsequent five year period in the event the defendants would continue to wrongfully withhold the payment of dividends.

Another squeeze technique requiring an extraordinary remedy is that of removing a shareholder from his positions of employment and management. A close corporation shareholder will typically invest a substantial portion of his personal resources in the enterprise, and will depend exclusively on the corporation for his employment and income. If excluded from employment, the shareholder is effectively denied a return on his investment.

Such was the situation in Hallahan v. Haltom Corp. Four shareholders with equal interests in the corporation caused it to issue a small number of shares to a fifth person as partial payment for work he performed. Before the fifth person received his shares, he signed a proxy in favor of Thompson, one of the original owners. Thereafter a dispute divided the four original shareholders into two factions. The Thompson faction used the proxy to terminate the employment of the two opposing shareholders. The court ruled that the peremptory discharge violated the fiduciary duty owed among close corporation shareholders. Redemption of the fifth person’s shares was ordered, thereby restoring the corporate structure originally envisioned.

In an unusual and interesting case, Atkinson v. Marquart, the Supreme Court of Arizona readily disregarded

73. Id. at 770.
74. Id. at 775. The court relied on Patton v. Nicholas, 154 Tex. 385, 279 S.W.2d 848 (1955) where the minority shareholder was granted a similar remedy.
75. O’NEAL, supra note 1, § 3.06 at 78.
76. Id.
78. Id. at 1034.
79. Id. at 1035.
the separate legal personality of the corporation in order to grant effective relief to a close corporation shareholder. Atkinson and Marquart had converted their partnership into corporate form and continued to engage in the business of custom rifle manufacture and repair. Several years later Atkinson began a competing business and falsely represented to his customers that the corporation could no longer make and repair custom rifles.

Atkinson was found liable, not to the corporation, but to Marquart personally. Citing Pearlman v. Feldmann, the court determined that any judgment in favor of the corporation would also benefit Atkinson, the wrongdoer. Therefore, Marquart was entitled to recover in his own right instead of through the corporation.

The Superior Court of New Jersey extended the doctrine by permitting a close corporation shareholder personal recovery without qualification. The court recognized the traditional principle that a shareholder has no individual claim for loss in value of his investment resulting from actions taken by a director. However, the court ruled that the relationship of the principals was that of partners or coventurers. Accordingly, application of the conventional rule was found to be unjustified since the corporate personality was not separate from its shareholders. The court then pierced the corporate veil and held the defendant liable to the plaintiff personally.

It appears that the courts' reasoning in this category of cases may very well rest on the parties' expectations. When one or more of the close corporation members reaches the conclusion that he or she has been wronged and seeks a judicial remedy for that wrong, it is not difficult to comprehend the frustration felt when they discover it is not they,

83. Id. at 84.
84. Id. at 85.
85. Id. at 84.
86. Cf., Peters Grazing Ass'n v. Legerski, 544 P.2d 449 (Wyo. 1975), reh. denied 546 P.2d 189 (1976) (given appropriate circumstances, the corporate fiction will be stripped away and the individuals held liable).
individually, who have been wronged, but rather the corporation. Therefore, often to the surprise of the parties, only the corporation may recover for the wrong.

An additional remedy that should not be overlooked is that of punitive damages. In Nash v. Craigco, Inc., the plaintiff and defendant formed a corporation and issued 1,000 shares of capital stock. The defendant received all 1,000 shares but, pursuant to a prior agreement, gave to the plaintiff an option to purchase 501 of the 1,000 shares. However, before plaintiff had exercised his option, the defendant caused the issuance of 14,700 additional shares to himself and his wife. Several weeks later the defendant dishonored plaintiff's option, and informed plaintiff of the additional shares which would diminish his interest in the corporation.

The court ordered the defendant to convey the 501 shares of stock to plaintiff and caused the corporation to rescind the additional 14,700 shares. In addition, the plaintiff was awarded punitive damages. Despite a vigorous dissenting opinion, the court reasoned that punitive damages are proper where relief other than money damage is sought.

Involuntary Dissolution for Oppression

Another method for providing relief to oppressed shareholders is that of dissolution. However, under traditional corporate doctrines, dissolution is available only in limited, specified conditions and, in any case, is considered to be a drastic remedy. But dissolution of a partnership is much more simple and flexible, the rule being that any partner may dissolve the enterprise at will. Although legal scholars have long advocated increased use of involuntary dissolution procedures, the courts have generally been reluctant to dis-

88. Id. at 780 (dissenting opinion): "Punitive damages are contrary to the principles of equity jurisprudence, for equity abhors a penalty or forfeiture and seeks to restore the parties to their status quo." (Footnotes omitted).
89. Id. at 777. See also 68th Street Apartments, Inc. v. Lauricella, supra note 82, at 89 (if close corporation shareholders act in a malicious and unjustified manner, they shall be liable for punitive damages).
91. UNIFORM PARTNERSHIP ACT § 31.
solve a corporation, sensing that termination of a formerly viable concern is not to be taken lightly.\footnote{Hetherington & Dooley, Illiquidity and Exploitation: A Proposed Statutory Solution to The Remaining Close Corporation Problem, 63 Va. L. Rev. 1, 27 (1977).}

A majority of the states, including Wyoming, now have statutes which give to the courts power to grant dissolution upon a showing of oppression or comparable grounds, such as deadlock, fraud or illegality.\footnote{See, e.g., Wyo. Stat. § 17-1-614 (1977).} Notwithstanding the broad statutory power, dissolution continues to be discretionary: whether the case presented involves deadlock\footnote{In re Radom & Neidorff, 307 N.Y. 1, 119 N.E.2d 563, 565 (1954) (the court refused to grant dissolution even where deadlock as defined in the statute was shown to exist).} or oppression,\footnote{In Baker v. Commercial Body Builders, Inc., 264 Or. 614, 507 P.2d 387, 385, 388 (1973), the appellate court agreed that the defendant's conduct had been oppressive, but nevertheless declined to order dissolution.} the courts are still hesitant to decree the dissolution of a solvent corporation.

As difficult as corporate dissolution may be, it is somewhat more available to a dissident close corporation shareholder. The notion that a close corporation resembles a partnership is an important factor in the more liberal view.\footnote{Weiss v. Gordon, 32 App. Div.2d 279, 301 N.Y.S.2d 838, 842 (1969).} The analogy between close corporations and partnerships would imply that the right to corporate dissolution, like the partner's right of liquidation, must be unconditional. Professor Hetherington suggests that

Personal relations [within the close corporation] may become so unsatisfactory that no amount of commercial success is adequate recompense. Only the participants can judge when continuation of an association becomes intolerable. Denial of the right to withdraw on reasonable terms forces upon the minority the choice of continuing an unacceptable association, or in effect abandoning its investment. The lack of reasonable alternatives compels a continuation of the association by legal constraint —what was once called "togetherness by injunction" —a prospect which scarcely seems a desirable policy goal.\footnote{Hetherington, Special Characteristics, Problems, and Needs of the Close Corporation, 11 U. Ill. L. F. 1, 29 (1969).}
Yet it seems that the courts are entirely proper in their refusal to liberalize dissolution where other equitable relief is available. The granting of relief for breach of fiduciary duty would be much less drastic than dissolution, and the concept that an operative corporation should not be dissolved if otherwise avoidable would be preserved.

Perhaps most important, however, a potential source of much needed risk capital for close corporation shareholders would be threatened by a liberalized dissolution procedure. Upon dissolution, the investments made by outside investors, creditors and close corporation participants may be adversely affected. Undoubtedly, if dissolution decrees were to be granted as a matter of course, these persons would choose to invest their money elsewhere.

**CONCLUSION**

The more conventional remedies have generally failed to provide close corporation shareholders any real protection. Thus, the trend now is to apply a broad protective standard allowing the courts to meet the variety of situations encountered in close corporation squeeze-out cases. The partnership-like standard of utmost good faith and loyalty is mandated by the peculiarities of close corporation life and the unavailability of remedies for close corporation participants.

There is a noticeable tendency for the courts to avoid indiscriminate application of the business judgment rule to sustain action taken by close corporation directors. By eliminating the judicial reluctance to question the internal business practices of an enterprise, the courts are able to intervene when necessary to protect close corporation shareholders against oppressive action even though fraud or bad faith cannot be shown. Similarly, the traditional principle of majority rule is often found to be less stringently applied to closely held corporations. It is hoped that the growing availability of relief will temper oppressive action. While protection should be afforded the individual shareholder,
perhaps a more important consideration is the economic benefit attributable to the imposition of the strict fiduciary duty.

The issue arises, however, whether the contemporary approach presents an unnecessary conflict between corporate norms and corporate conduct. The normative offerings include limited liability, perpetual existence and other attractions for those considering incorporation. The possibility must be considered that indiscriminate interjection of partnership law into the corporate area might conceivably bifurcate or dilute the corporate norms needlessly.

A more workable and appealing alternative to the bifurcation of the corporate norms must deal with the prospect of removing closely held corporations from the corporate scheme altogether. If the bifurcated system is retained, care must be exercised not to indiscriminately accord extraordinary treatment such that the normative offerings will suffer adversely.

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